

In the opinion of Ungaretti & Harris LLP and Pugh, Jones & Johnson, P.C., both of Chicago, Illinois, Co-Bond Counsel, subject to compliance with certain covenants made by the Board to satisfy pertinent requirements of the Internal Revenue Code of 1986, as amended, under present law, interest on the Bonds described herein is excludable from gross income of the owners thereof for Federal income tax purposes. Interest on the Bonds will not be included as an item of tax preference for purposes of the Federal alternative minimum tax imposed on individuals and corporations. However, interest on the Bonds will be taken into account in computing the corporate alternative minimum tax. Interest on the Bonds is not exempt from income taxes currently imposed by the State of Illinois. See the caption “TAX MATTERS” herein regarding a description of other tax considerations.



\$257,925,000
BOARD OF EDUCATION OF THE
CITY OF CHICAGO
Unlimited Tax General Obligation Bonds
(Dedicated Revenues), Series 2003D
(Auction Rate Securities)



Initial Auction Periods, Initial Broker-Dealers, First Auction Dates and First Interest Payment Dates,
as shown on Inside Cover

Dated: Date of Issuance

Price: 100%

Due: Series 2003D-1: March 1, 2014
Series 2003D-2: March 1, 2022
Series 2003D-3: March 1, 2034
Series 2003D-4: March 1, 2034

This Official Statement contains information relating to the Bonds while bearing interest in the Auction Rate Mode. Purchasers of the Bonds should not rely on this Official Statement for information relating to the Bonds bearing interest in the Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode. If any Bonds are converted to a Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode, it is expected that the Board will supplement this Official Statement or deliver a new Official Statement or other disclosure document describing the Bonds bearing interest in the Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode.

The Bonds are fully registered bonds in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Bonds. Purchasers of the Bonds will not receive certificates representing their interests in the Bonds purchased. Principal of and interest on the Bonds will be paid by the Trustee to DTC, which in turn will remit such principal and interest payments to its participants for subsequent disbursement to the beneficial owners of the Bonds. As long as Cede & Co. is the registered owner as nominee of DTC, payments on the Bonds will be made to such registered owner, and disbursement of such payments to beneficial owners will be the responsibility of DTC and its participants. See “THE BONDS—Book-Entry Only System” herein. During any Auction Rate Mode, the Bonds are issuable in denominations of \$25,000 and any integral multiple thereof.

The Bonds will be initially issued in the Auction Rate Mode. The Bonds will be issued in four Subseries, as identified above. Each Subseries will bear interest for the applicable Initial Interest Period (from and including the date of issuance to and including the applicable Initial Auction Date) at the applicable Initial ARS Rate. After the applicable Initial Interest Period, the Bonds will bear interest at the ARS Rate determined pursuant to the Auction Procedures for the appropriate Auction Period until a conversion to another Auction Period, or until an Adjustment Date as described herein. Regularly scheduled interest will be payable (i) during any Auction Period other than a Special Auction Period, on the Business Day immediately following such Auction Period and (ii) during any Special Auction Period of (a) seven or more but fewer than 92 days, the Business Day immediately following such Special Auction Period or (b) 92 or more days, such day of the week applicable to a Subseries designated by the Broker-Dealer of each thirteenth week after the first day of such Special Auction Period or the next Business Day if such day of the week applicable to the Subseries is not a Business Day and on the Business Day immediately following such Special Auction Period.

The proceeds from the sale of the Bonds, together with certain moneys of the Board, will be used (i) to finance the Board’s Capital Improvement Program, (ii) to pay capitalized interest on the Bonds, (iii) to pay costs of issuance of the Bonds and, (iv) for other lawful purposes. See “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Capital Improvement Program” and “THE BONDS—Estimated Sources and Uses of Funds.”

The Bonds will be a general obligation of the Board to the payment of which the Board will pledge its full faith and credit. The Bonds will be payable from Pledged State Aid Revenues described herein, consisting of certain General State Aid Revenues, and from Pledged Taxes, all as described herein. To the extent that the Pledged State Aid Revenues are insufficient to pay the debt service on the Bonds, the Bonds will be payable from ad valorem taxes levied by the Board, without limitation as to rate or amount, against all of the taxable property in the school district governed by the Board, the boundaries of which are coterminous with the boundaries of the City of Chicago. The Bonds are also payable from all Funds, Accounts and Sub-Accounts established pursuant to the Indenture as security for the Bonds. See “SECURITY FOR THE BONDS.”

The scheduled payment of principal of and interest on the Series 2003D-2 Bonds, the Series 2003D-3 Bonds and the Series 2003D-4 Bonds when due will be guaranteed under three separate municipal bond insurance policies (the “Policies”) to be issued concurrently with the delivery of the Bonds by XL Capital Assurance Inc. (the “Bond Insurer”). See “BOND INSURANCE.”



Payment of principal of and interest on the Series 2003D-1 Bonds is not guaranteed by the Bond Insurer under the Policies.

The Bonds will be subject to optional and mandatory sinking fund redemption prior to maturity, as more fully described in this Official Statement.

The Bonds are being offered when, as and if issued and received by the Underwriters, subject to the delivery of separate approving legal opinions of Ungaretti & Harris LLP and Pugh, Jones & Johnson, P.C., both of Chicago, Illinois, Co-Bond Counsel. Certain legal matters will be passed upon for the Board by its General Counsel, Ruth M. Moscovitch, and by Piper Rudnick LLP, Chicago, Illinois, and for the Underwriters by their Co-Counsel, Vedder, Price, Kaufman & Kammholz, P.C. and Sanchez & Daniels, both of Chicago, Illinois. Delivery of the Bonds is expected to be made through the facilities of DTC in New York, New York, on or about December 12, 2003.

Lehman Brothers
Goldman, Sachs & Co.

M. R. Beal & Company

UBS Financial Services Inc.
RBC Dain Rauscher

\$257,925,000

BOARD OF EDUCATION OF THE CITY OF CHICAGO
Unlimited Tax General Obligation Bonds
(Dedicated Revenues), Series 2003D
(Auction Rate Securities)
Dated: Date of Delivery

Price: 100%

Subseries designation	2003D-1	2003D-2	2003D-3	2003D-4
Principal Amount.....	\$50,025,000	\$65,000,000	\$71,450,000	\$71,450,000
Maturity Date.....	3/01/2014	3/01/2022	3/01/2034	3/01/2034
Last Day of Initial Interest Period.....	12/23/2003	1/22/2004	2/5/2004	12/23/2003
First Auction Date.....	12/23/2003	1/22/2004	2/5/2004	12/23/2003
First Interest Payment Date.....	12/24/2003	1/23/2004	2/6/2004	12/24/2003
Initial Auction Period.....	11 days	41 days	55 days	11 days
Subsequent Auction Periods	7 days	35 days	35 days	7 days
Auction Day.....	Tuesday	Thursday	Thursday	Tuesday
Initial Broker-Dealers	Goldman, Sachs & Co. Lehman Brothers	Lehman Brothers UBS Financial Services Inc. RBC Dain Rauscher	Lehman Brothers M.R. Beal & Company RBC Dain Rauscher	UBS Financial Services Inc. Lehman Brothers Goldman, Sachs & Co.

Prospective purchasers of the Bonds should carefully review the Auction Procedures described in APPENDIX E of this Official Statement, and should note that such procedures provide that (i) a Bid or Sell Order constitutes a commitment to purchase or sell Bonds based upon the results of an Auction, (ii) Auctions will be conducted through telephone, facsimile transmission or other similar electronic means of communication and (iii) settlement for purchases and sales will be made on the Business Day following an Auction. Beneficial interests in each Subseries of Bonds may be transferred only pursuant to a Bid or Sell Order placed in an Auction or to or through the respective Broker-Dealers listed above.

REGARDING USE OF THIS OFFICIAL STATEMENT

No dealer, broker, salesperson, or other person has been authorized by the Board or the Underwriters to give any information or to make any representation with respect to the Bonds, other than those contained in this Official Statement, and, if given or made, such other information or representation must not be relied upon as having been authorized by any of the foregoing. This Official Statement is neither an offer to sell nor the solicitation of an offer to buy, nor shall there be any sale of the Bonds offered hereby, by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information and expressions of opinion set forth herein have been furnished by the Board and include information from other sources that the Board believes to be reliable. Such information is not guaranteed as to accuracy or completeness, and is not to be construed as a representation by the Underwriters. Such information and expressions of opinion are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change since the date hereof. Neither this Official Statement nor any statement that may have been made verbally or in writing is to be construed as a contract with the registered or beneficial owners of the Bonds.

This Official Statement should be considered in its entirety. All references herein to laws, agreements and documents are qualified in their entirety by reference to the definitive forms thereof, and all references to the Bonds are further qualified by reference to the information with respect thereto contained in the Indenture for the Bonds. Copies of the Indenture are available for inspection at the offices of the Board and the Trustee. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information. The information contained herein is provided as of the date hereof and subject to change.

These securities have not been recommended by any federal or state securities commission or regulatory authority. Furthermore, the foregoing authorities have not confirmed the accuracy or determined the adequacy of this document. Any representation to the contrary is a criminal offense.

IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE THAT MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENTS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

Certain capitalized terms used in this Official Statement and in the Indenture are defined in APPENDIX B and unless otherwise indicated shall have the respective meanings set forth therein.

Other than with respect to information concerning XL Capital Assurance Inc. (the “Bond Insurer”) contained under the caption “BOND INSURANCE” and APPENDIX-D—“SPECIMEN MUNICIPAL BOND INSURANCE POLICY” herein, none of the information in this Official Statement has been supplied or verified by the Bond Insurer and the Bond Insurer makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds; or (iii) the tax exempt status of the interest on the Bonds.

**BOARD OF EDUCATION OF
THE CITY OF CHICAGO**

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Financial Advisors

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\$257,925,000

**BOARD OF EDUCATION OF THE
CITY OF CHICAGO
Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D**

**Consisting of
\$50,025,000 Series 2003D-1
\$65,000,000 Series 2003D-2
\$71,450,000 Series 2003D-3
\$71,450,000 Series 2003D-4
(Auction Rate Securities)**

INTRODUCTION

General

The purpose of this Official Statement, including the cover page, the inside cover page and the Appendices hereto, is to set forth information in connection with the offering and sale by the Board of Education of the City of Chicago (the “Board”) of its \$257,925,000 Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D consisting, of \$50,025,000 aggregate principal amount of Series 2003D-1 Bonds (the “Series 2003D-1 Bonds”), the \$65,000,000 aggregate principal amount of Series 2003D-2 Bonds (the “Series 2003D-2 Bonds”), and \$71,450,000 aggregate principal amount of Series 2003D-3 Bonds (the “Series 2003D-3 Bonds”), and \$71,450,000 aggregate principal amount of Series 2003D-4 Bonds (the “Series 2003D-4 Bonds”), and, together with the Series 2003D-1 Bonds, the Series 2003D-2 and the Series 2003D-3 Bonds, the “Bonds”). All capitalized terms used in this Official Statement and not otherwise defined herein have the same meanings as assigned thereto in APPENDIX B—“SUMMARY OF CERTAIN TERMS OF THE INDENTURE” and, with respect to certain terms related to the ARS Bonds, APPENDIX E—“AUCTION PROCEDURES.”

This Official Statement describes only the terms and provisions applicable to the Bonds while in the Auction Rate Mode. If the Interest Mode applicable to the Bonds is changed to the Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode, it is expected that the Board will supplement this Official Statement or deliver a new official statement or other disclosure document describing the Bonds in the Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode. Purchasers of the Bonds should not rely on this Official Statement for information relating to the Bonds bearing interest in the Weekly Mode, Flexible Mode, Term Rate Mode or Fixed Mode.

The Bonds will be a general obligation of the Board to the payment of which the Board will pledge its full faith and credit. The Bonds will be issued by the Board pursuant to the provisions of the School Code of the State of Illinois, as amended (the “School Code”), the Local Government Debt Reform Act of the State of Illinois, as amended (the “Debt Reform Act”), a resolution adopted by the Board on July 24, 2002 (the “2002 Authorization”) authorizing the issuance of alternate bonds, being general obligation bonds payable from any revenue source as provided by the Debt Reform Act (“Alternate Bonds”), in an amount not to exceed \$500,000,000, and a resolution adopted by the Board on November 19, 2003 (the “Bond Resolution” and, together with the 2002 Authorization, the “Resolutions”), and a Trust Indenture, dated as of December 1, 2003 (the “Indenture”), by and between the Board and Deutsche Bank National Trust Company, Chicago, Illinois, as trustee (the “Trustee”). The Bonds will be secured by and are payable (i) from the Pledged State Aid Revenues (as defined below), (ii) to the extent that the Pledged State Aid Revenues are insufficient to pay the debt service on the Bonds, from the ad valorem taxes levied by the Board, pursuant to the Bond Resolution, against all of the taxable

property in the School District (as defined herein), without limitation as to rate or amount, and pledged under the Indenture as security for the Bonds (the “Pledged Taxes”) and (iii) from all Funds, Accounts and Sub-Accounts established pursuant to the Indenture. No Alternate Bonds payable from the Pledged State Aid Revenues have been issued pursuant to the 2002 Authorization.

The Pledged State Aid Revenues consist of a specified annual amount of unrestricted General State Aid payments to be made to the Board in any year pursuant to Article 18 of the School Code. For additional information, see “SECURITY FOR THE BONDS—General” and “—General State Aid” below. For a discussion of other obligations of the Board payable from the Board’s annual receipt of General State Aid payments see “—Prior Alternate Bonds” and “—Other State Aid Obligations” below.

The Bonds will bear interest initially in the Auction Rate Mode. On the date of issuance of the Bonds, the Board will enter into two interest rate swap agreements. See “THE BONDS—Interest Rate Swap Agreements.” The Swap Payments to be made by the Board under the interest rate swap agreements are payable from the Pledged State Aid Revenues and Pledged Taxes on a subordinate basis to the Bonds. See “SECURITY FOR THE BONDS—Payment of Debt Service on the Bonds and Swap Payments.”

The scheduled payment of principal of and interest on the Series 2003D-2 Bonds, the Series 2003D-3 Bonds and the Series 2003D-4 Bonds when due will be guaranteed under three separate municipal bond insurance policies (the “Policies”) to be issued concurrently with the delivery of the Bonds by XL Capital Assurance Inc. (the “Bond Insurer”). For additional information, see “BOND INSURANCE.”

The payment of principal of and interest on the Series 2003D-1 Bonds is not guaranteed by the Bond Insurer under the Policies.

The Board is issuing the Bonds to provide funds for the continued implementation of its Capital Improvement Program. For additional information, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Capital Improvement Program.”

Prior Alternate Bonds

The Board has previously issued its Alternate Bonds in the aggregate principal amount of \$3.6 billion to finance its Capital Improvement Program (the “Prior Alternate Bonds”). The Prior Alternate Bonds are payable from sources other than the Pledged State Aid Revenues. In the event such other sources are insufficient or not available for payment of the Prior Alternate Bonds, the Prior Alternate Bonds are payable from ad valorem taxes levied by the Board. For additional information, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Outstanding Debt Obligations.” Certain of the Prior Alternate Bonds were issued as “qualified zone academy bonds” pursuant to the Internal Revenue Code of 1986, as amended (the “Code”). For additional information, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Capital Improvement Program.”

Other State Aid Obligations

Certain of the Prior Alternate Bonds were issued, and additional obligations of the Board may be issued in the future, to finance the Board’s Capital Improvement Program. Outstanding Prior Alternate Bonds are, and additional obligations of the Board may be, secured by (i) a pledge of up to \$100,000,000 of the General State Aid payments to be received by the Board in any year (the “1997 Authorization Revenues”) pursuant to a resolution adopted by the Board on October 7, 1997 (the “1997 Authorization”), (ii) a pledge of up to \$175,000,000 of the General State Aid payments to be received by the Board in any year (the “1998 Authorization Revenues”) pursuant to a resolution adopted by the Board on August 26,

1998 (the “1998 Authorization”), and (iii) a pledge of up to \$75,000,000 of the General State Aid payments to be received by the Board in any year (the “2001 Authorization Revenues,” and together with the 1998 Authorization Revenues and are the 1997 Authorization Revenues, the “Prior Authorization Revenues”) pursuant to a resolution adopted by the Board on November 28, 2001 (the “2001 Authorization,” and together with the 1998 Authorization and the 1997 Authorization, the “Prior Authorization”). The Pledged State Aid Revenues and the Prior Authorization Revenues are each derived from the collections of General State Aid payments by the Board in each year. None of the obligations secured by the Prior Authorization Revenues have a claim on that portion of the General State Aid payments received in each year by the Board constituting the Pledged State Aid Revenues, and the Bonds are not secured by that portion of the General State Aid payments received in each year by the Board constituting the Prior Authorization Revenues. See “SECURITY FOR THE BONDS—General” and “—General State Aid” and “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Capital Improvement Program—Future Financings.”

THE BONDS

General

The Bonds will consist of four subseries (each a “Subseries”), will be dated their date of issuance and delivery and will mature as shown on the cover. The Bonds will be in an Auction Rate Mode from the date of issuance and will bear interest for the applicable Initial Interest Periods (from and including the date of original delivery to and including the respective Initial Auction Dates) at the respective Initial ARS Rates, and thereafter at the applicable ARS Rate determined pursuant to the Auction Procedures appropriate for the Auction Period, unless the length of the Auction Period is changed or the Interest Mode is changed. The date on which a Bond is converted to bear interest in a new Interest Mode, including any Term Rate Conversion Date or the Fixed Rate Conversion Date, is hereinafter referred to as an “Adjustment Date.” The Auction Procedures applicable during the Auction Rate Mode are more fully described in APPENDIX E.

Each Subseries of Bonds may be converted to a Weekly Mode, a Flexible Mode, a Term Rate Mode or a Fixed Mode. If a Subseries of the Bonds were converted to a Weekly Mode, a Flexible Mode, a Term Rate Mode or a Fixed Mode, the Bonds of such Subseries would be subject to a mandatory tender for purchase at a purchase price equal to 100% of the principal amount thereof plus accrued interest. See “Conversion of ARS Bonds to Fixed Rates, Weekly Rates, Term Rates or Flexible Rates.” There is no mandatory tender if a Subseries of the Bonds were to change from one Auction Period to another Auction Period. In connection with the mandatory tender that would occur on an Adjustment Date upon a conversion of the Bonds to a Weekly Mode, a Flexible Mode, a Term Rate Mode or a Fixed Mode, a new official statement would be prepared describing in detail the provisions of the Indenture that would apply during any such Interest Mode.

The Bonds initially are registered through a book-entry only system operated by The Depository Trust Company, New York, New York (“DTC”). Details of payments of the Bonds and the book-entry only system are described below under the subcaption “—Book-Entry Only System.” Except as described under the subcaption “—Book-Entry Only System” below, beneficial owners of the Bonds will not receive or have the right to receive physical delivery of Bonds, and will not be or be considered to be the registered owners thereof. Accordingly, beneficial owners must rely upon (i) the procedures of DTC and, if such beneficial owner is not a DTC “Participant” (as defined below), the Participant who will act on behalf of such beneficial owner to receive notices and payments of principal and purchase price of, premium, if any, and interest on the Bonds, and to exercise voting rights and (ii) the records of DTC and, if such beneficial owner is not a Participant, such beneficial owner’s Participant, to evidence its beneficial ownership of the Bonds. So long as DTC or its nominee is the registered owner of the Bonds, references

herein to Bondholders or registered owners of such Bonds mean DTC or its nominee and do not mean the beneficial owners of such Bonds.

The Bonds may bear interest in accordance with any of the following interest rate periods:

<u>Interest Rate Period</u>	<u>Length of Period</u>
Auction Period	
Seven-day	Seven days
28-day	28 days
35-day	35 days
Three-month	Three months
Six-month	Six months
Special Auction Period	Not shorter than seven days nor longer than 365 days
Weekly Rate	Seven days
Flexible Rate	Not shorter than 2 days nor longer than 366 days
Term Rate.....	Not shorter than 12 months nor longer than the maturity date
Fixed Rate	From Fixed Rate Conversion Date to maturity

As used in this Official Statement, Bonds that bear interest at ARS Rates are sometimes referred to as “ARS Bonds.”

Description of the ARS Bonds

The following description applies to the ARS Bonds. Certain terms related to the ARS Bonds are defined below. A complete description of the Auction Procedures, including additional definitions related to the ARS Bonds, is set forth in APPENDIX E.

Interest on the ARS Bonds in a seven-day, a 28-day, a 35-day, a three month, a six month or a Special Auction Period of 180 days or less shall be computed on the basis of a 360-day year for the actual number of days elapsed. Interest on the ARS Bonds in a Special Auction Period of more than 180 days shall be computed on the basis of a 360-day year of twelve 30-day months.

The ARS Bonds will be issued as fully registered bonds without coupons and in denominations of \$25,000 or any integral multiple thereof. Fully registered bonds are interchangeable for other fully registered bonds of the same Subseries in Authorized Denominations upon terms and conditions provided in the Indenture.

“*ARS Rate*” means with respect to each Subseries of ARS Bonds, the rate of interest to be borne by such Bonds during each Auction Period which (other than for the Initial Period) shall equal the Auction Rate for each Auction Period; provided, however, that, if the Auction Agent shall have failed to determine, or for any reason fails to timely provide the Auction Rate for any Auction Period the ARS Rate for such Auction Period shall be the No Auction Rate determined for such Auction Period; provided, further, that if an Event of Default resulting from a failure by the Board to pay principal, premium or interest on any Bond when due and a failure of the Bond Insurer to pay when due a claim properly made under the Bond Insurance Policy (a “Payment Default”) shall have occurred, the ARS Rate for the Auction Period during which such Payment Default shall have occurred and each Auction Period thereafter commencing prior to two (2) Business Days after the date on which the Payment Default shall have ceased to continue, shall be the Default Auction Rate for such Auction Period; and provided, further,

in the event of a failed conversion from an Auction Rate Mode to a Fixed Mode, Weekly Mode, Term Rate Mode or Flexible Mode or a failed conversion from one Auction Period to another Auction Period the affected ARS Bonds will continue as ARS Bonds with a seven-day Auction Period and bear interest at the Maximum ARS Rate for the next Auction Period. In no event may the ARS Rate for any Subseries of Bonds exceed the Maximum Interest Rate.

“Auction Date” means, with respect to any Subseries of ARS Bonds, during any period in which the Auction Procedures are not suspended in accordance with the provisions of the Indenture (i) if the ARS Bonds are in a Special Auction Period, the last Business Day of the Special Auction Period, and (ii) if the ARS Bonds are in any other Auction Period, the Business Day next preceding each Interest Payment Date for such ARS Bonds (whether or not an Auction will be conducted on such date); *provided, however*, that the last Auction Date with respect to the ARS Bonds in an Auction Period or a Special Auction Period will be the earlier of (a) the Business Day next preceding the Interest Payment Date next preceding the Adjustment Date on which the ARS Bonds will be converted to another Interest Mode and (b) the Business Day next preceding the Interest Payment Date next preceding the Maturity Date for the ARS Bonds. The last Business Day of a Special Auction Period will be the Auction Date for the Auction Period which begins on the next succeeding Business Day, if any.

“Auction Period” means, (i) a Special Auction Period, (ii) with respect to a Subseries of ARS Bonds in a seven-day mode, a period of generally seven days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on the day of the week designated by the Broker-Dealer thereafter (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) with respect to a Subseries of ARS Bonds in the 28-day mode, a period of generally 28 days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on such day of the fourth week thereafter designated by the Broker-Dealer (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) with respect to a Subseries of ARS Bonds in the 35-day mode, a period of generally 35 days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on such day of the fifth week thereafter designated by the Broker-Dealer (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (v) with respect to a Subseries of ARS Bonds in a three-month mode, a period of generally three months (or shorter period upon conversion from another Auction Period) beginning on the date following the last day of the prior Auction Period and ending on such same day of the week that is most closely three months following the beginning date of such Auction Period, and (vi) with respect to a Subseries of ARS Bonds in a six-month mode, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on such same day of the week that is most closely six months following the beginning date of such Auction Period. After the Initial Interest Periods and until converted to another Auction Period or another Interest Mode as provided in this Indenture, the Series 2003D-1 Bonds shall be in a 7-day mode, the Series 2003D-2 Bonds shall be in a 35-day mode, the Series 2003D-3 Bonds shall be in a 35-day mode, and the Series 2003D-4 Bonds shall be in a 7-day mode.

“Auction Rate” means for any Subseries of ARS Bonds for each Auction Period, (i) if Sufficient Clearing Bids exist, the Winning Bid Rate for such Subseries, provided, however, if all of the ARS Bonds are the subject of Submitted Hold Orders, the Minimum ARS Rate for the ARS Bonds and (ii) if Sufficient Clearing Bids do not exist, the Maximum ARS Rate for the ARS Bonds.

“Broker-Dealer Rate” means a rate of 0.25% per annum with respect to the ARS Bonds or such different rates as may be established pursuant to a Broker-Dealer Agreement.

“Initial Auction Dates” means (i) with respect to the Series 2003D-1 Bonds, December 23, 2003, (ii) with respect to the Series 2003D-2 Bonds, January 22, 2004, (iii) with respect to the Series 2003D-3 Bonds, February 5, 2004, and (iv) with respect to the Series 2003D-4 Bonds, December 23, 2003.

“Initial Interest Payment Date” with respect to each Subseries of Bonds, means the day next succeeding the last day of the respective Initial Interest Period, or if any such date is not a Business Day, the next succeeding Business Day (but only for interest accrued through the last day of such Initial Interest Period next proceeding such Initial Interest Payment Date).

“Initial Interest Period” with respect to each Subseries of the Bonds, means the period from and including the date of original delivery of the Bonds to and including the respective Initial Auction Date.

Auction Agent

The Indenture provides that when Bonds are in the Auction Rate Mode, the Trustee shall, at the direction of the Board, appoint an Auction Agent. The Trustee and the Auction Agent will enter into an Auction Agreement that will provide, among other things, that the Auction Agent will determine the Auction Rate for each Auction in accordance with the Auction Procedures. The Trustee will enter into the Auction Agreement initially with Deutsche Bank Trust Company Americas, New York, New York, as agent for the Trustee, which agent shall perform the duties of Auction Agent with respect to the Bonds. See APPENDIX-E—“AUCTION PROCEDURES—Auction Agent.”

Auction Date

An Auction to determine the interest rate with respect to ARS Bonds for the next succeeding Auction Period will be held on each Auction Date. The first Auction Date with respect to the Series 2003D-1 Bonds will take place on December 23, 2003, for the Series 2003D-2 Bonds, January 22, 2004, for the Series 2003D-3 Bonds, February 5, 2004 and for the Series 2003D-4 Bonds, December 23, 2003.

Order Procedures for Existing Owners and Potential Owners

The procedure for submitting orders prior to the Submission Deadline on each Auction Date is described in APPENDIX E, as are the particulars with regard to the determination of the Auction Rate and the allocation of Bonds bearing interest at ARS Rates (collectively, the “Auction Procedures”).

Conversion of ARS Bonds to Fixed Rates, Weekly Rates, Term Rates or Flexible Rates

The Bonds within each Subseries shall operate in the same Interest Mode at the same time; provided, however, that the Board may direct that all or, with Bond Insurer approval, any portion of the ARS Bonds of a Subseries be converted on an Adjustment Date to bear interest at a Fixed Rate, a Weekly Rate, Term Rate or a Flexible Rate, provided that after any partial conversion there are not less than \$10,000,000 of ARS Bonds of such Subseries outstanding. The Board may designate a different Interest Mode with respect to any ARS Bond on the last Interest Payment Date for any Auction Period. Not less than fifteen days prior to the Adjustment Date on which ARS Bonds will be converted to the Weekly Mode, the Flexible Mode, Term Rate Mode or the Fixed Mode, the Trustee will mail a written notice of the conversion to the Owners of all ARS Bonds to be converted, specifying the Adjustment Date, the last day of the Adjustment Period then ending and that such Bond is required to be purchased on the Adjustment Date. On the Adjustment Date applicable to the ARS Bonds to be converted, such ARS

Bonds to be converted shall be subject to mandatory tender at a purchase price equal to 100% of the principal amount thereof, plus accrued interest. The purchase price of the ARS Bonds so tendered is payable solely from the proceeds of the remarketing of such Bonds. In the event that the conditions of a conversion are not satisfied, including the failure to remarket all applicable ARS Bonds on a mandatory tender date, the ARS Bonds will not be subject to mandatory tender, will be returned to their owners, will automatically convert to a seven-day Auction Period and will bear interest at the Maximum ARS Rate. See “Failed Conversions.” It is currently anticipated that, should any of the Bonds be converted to bear interest at a Weekly Rate, a Flexible Rate, Term Rate or a Fixed Rate, an official statement will be distributed describing the Bonds during such Rate Period.

Conversion from One Auction Period to Another

On the conversion date for a Subseries from one Auction Period to another, any Bonds which are not the subject of a specific Hold Order or Bid will be deemed to be subject to a Sell Order. In the event of a failed conversion to another Auction Period due to the lack of Sufficient Clearing Bids, the next Auction Period will be a seven-day Auction Period and the Auction Rate for such period will be the Maximum ARS Rate. In connection with a conversion from one Auction Period to another, written notice of such conversion will be given in accordance with the Auction Procedures; however, the ARS Bonds will not be subject to mandatory tender on such conversion date. See APPENDIX-E—“AUCTION PROCEDURES—Changes in Auction Period or Auction Date.”

Special Considerations Relating to ARS Bonds

The Auction Procedures will be suspended during the period commencing on the date of the Auction Agent’s receipt of notice from the Trustee or the Board of the occurrence of an Event of Default resulting from a failure by the Board to pay principal, premium or interest on any Bond when due and a failure of the Bond Insurer to pay when due a claim properly made under the Bond Insurance Policy in respect thereof but will resume two Business Days after the date on which the Auction Agent receives notice from the Trustee that such Event of Default has been waived or cured, with the next Auction to occur on the next regularly scheduled Auction Date occurring thereafter.

The Indenture and the Auction Agreement provide that the Auction Agent may resign from its duties as Auction Agent by giving at least 90 days notice to the Board, the Bond Insurer and the Trustee. The Board may remove the Auction Agent upon 15 days notice. No such resignation or removal shall take effect until a successor Auction Agent has been appointed in accordance with the qualifications set forth in the Indenture; provided, however, that if the Auction Agent has not been compensated for its services, the Auction Agent may resign upon giving at least 60 days notice to the Board, the Bond Insurer and the Trustee and such resignation shall take effect upon the expiration of such 60 days if the Auction Agent has not then been paid even if a successor Auction Agent has not been appointed. The Broker-Dealer Agreement provides that the Broker-Dealer thereunder may resign upon thirty business days notice or immediately, in certain circumstances, and does not require, as a condition to the effectiveness of such resignation, that a replacement Broker-Dealer be in place. For any Auction Period during which there is no duly appointed Auction Agent, or during which there is no duly appointed Broker-Dealer, it will not be possible to hold Auctions, with the result that the interest rate on the ARS Bonds will be the No Auction Rate.

The Broker-Dealer Agreement will provide that the Broker-Dealer may submit an Order in Auctions for its own account. If the Broker-Dealer submits an Order for its own account in any Auction, it might have an advantage over other bidders in that it would have knowledge of orders placed through it in that Auction; such Broker-Dealer, however, would not have knowledge of Orders submitted by other Broker-Dealers (if any) in that Auction. In the Broker-Dealer Agreement, the Broker-Dealer will agree to

handle customer orders in accordance with their respective duties under applicable securities laws and rules.

The Broker-Dealers have advised the Board that they intend initially to make a market for the ARS Bonds between Auctions; however, the Broker-Dealers are not obligated to make such markets, and no assurance can be given that secondary markets therefor will develop.

Failed Conversions

If, on an Adjustment Date from the Auction Rate Mode, any condition precedent to such conversion required by the Indenture shall not be satisfied, including that the Bonds have not been successfully remarketed, the Trustee shall give written notice by first class mail postage prepaid as soon as practicable and in any event not later than the next succeeding Business Day to the Bondholders and the Bond Insurer that such conversion has not occurred, that the Bonds shall not be purchased on the failed Adjustment Date, that the Auction Agent shall continue to implement the Auction Procedures on the Auction Dates with respect to the Bonds which otherwise would have been converted, excluding however the Auction Date falling on the Business Day next preceding the failed Adjustment Date, and that the interest rate shall continue to be the ARS Rate; provided, however, that the interest rate borne by the Bonds during the Auction Period commencing on such failed Adjustment Date shall be the Maximum ARS Rate, and the Auction Period shall be the seven-day Auction Period.

Mandatory Tenders

The ARS Bonds are subject to mandatory tender for purchase upon the conversion to the Fixed Mode, Weekly Mode, Term Rate Mode or Flexible Mode. See “Conversion of ARS Bonds to Fixed Rates, Weekly Rates, Term Rates or Flexible Rates.” The owners of Bonds subject to such mandatory tender for purchase may not elect to retain such Bonds.

Redemption

Optional Redemption during Auction Rate Mode. During any Auction Rate Mode, the Bonds in such Interest Mode are subject to optional redemption prior to their Maturity Date at the option of the Board, in whole or in part (and if in part, in an Authorized Denomination) on the Business Day immediately succeeding any Auction Date, at a redemption price equal to 100 percent of the principal amount thereof plus accrued interest, if any, to the redemption date.

Mandatory Sinking Fund Redemption. The Bonds of each Subseries are subject to mandatory sinking fund redemption prior to their maturity at a redemption price equal to the principal amount thereof, plus accrued interest, if any, on March 1 in the respective years and in the respective amounts set forth below:

<u>Year</u>	<u>Principal Amount of Series 2003D-1 Bonds</u>	<u>Year</u>	<u>Principal Amount of Series 2003D-2 Bonds</u>
2005	\$3,925,000	2015	\$7,125,000
2006	4,125,000	2016	7,500,000
2007	4,350,000	2017	7,925,000
2008	4,550,000	2018	7,800,000
2009	4,825,000	2019	8,125,000
2010	5,100,000	2020	8,475,000
2011	5,350,000	2021	8,825,000
2012	5,600,000	2022*	9,225,000
2013	5,925,000		
2014*	6,275,000		

<u>Year</u>	<u>Principal Amount of Series 2003D-3 Bonds</u>	<u>Year</u>	<u>Principal Amount of Series 2003D-4 Bonds</u>
2023	\$4,700,000	2023	\$4,700,000
2024	4,875,000	2024	4,875,000
2025	5,100,000	2025	5,100,000
2026	5,325,000	2026	5,325,000
2027	5,550,000	2027	5,550,000
2028	5,775,000	2028	5,775,000
2029	6,025,000	2029	6,025,000
2030	6,275,000	2030	6,275,000
2031	6,525,000	2031	6,525,000
2032	6,800,000	2032	6,800,000
2033	7,100,000	2033	7,100,000
2034*	7,400,000	2034*	7,400,000

* *final maturity*

Redemption Procedures. Any redemption of less than all of the Bonds of a Subseries outstanding will be made from the Bonds as the Board shall designate. No optional redemption of less than all of the Bonds of a Subseries outstanding will be made unless the aggregate principal amount of Bonds to be redeemed is equal to \$25,000 or integral multiples thereof. Any redemption of less than all of the Bonds outstanding will be made in such a manner that all Bonds outstanding after such redemption are in Authorized Denominations.

If less than all of the Bonds are called for redemption under provisions of the Indenture permitting partial redemption, the particular Bonds (or portions thereof), to be redeemed will be selected by the Board, in the principal amount and particular Subseries designated by the Board, which designation is required to include the Interest Mode and particular Maturity Date of Bonds to be redeemed, or as otherwise required by the Indenture; provided that (i) in the case of the redemption of less than all of the Bonds in the same Interest Mode which bear interest at the same rate for the same Rate Periods, such redemption will be by lot in such manner as the Trustee may determine among such Bonds and (ii) subject to other applicable provisions of the Indenture, the portion of any Bond to be redeemed will be in a principal amount equal to an Authorized Denomination. In selecting Bonds for redemption, the Trustee will treat each Bond as representing that number of Bonds which is obtained by dividing the principal amount of such Bond by the minimum Authorized Denomination. If it is determined that one or

more, but not all, of the integral multiples of the Authorized Denomination of principal amount represented by any Bond is to be called for redemption, then, upon notice of intention to redeem such integral multiple of an Authorized Denomination, the owner of such Bond is required to surrender such Bond to the Trustee for payment to such owner of the redemption price of the integral multiple of the Authorized Denomination of principal amount called for redemption; the Trustee will deliver to such owner a new Bond or Bonds in the aggregate principal amount of the unredeemed balance of the principal amount of such Bond. New Bonds representing the unredeemed balance of the principal amount of such Bond will be issued to the registered owner thereof without charge therefor.

Should the Trustee have knowledge of an Event of Default under the Indenture, there shall be no partial redemption of the Bonds other than the mandatory sinking fund redemptions described above.

Notice of Redemption. For a description of the giving of notices while the Bonds are in the book-entry only system, see “—Book-Entry Only System,” below. Whenever Bonds are to be redeemed, the Trustee will give notice of the redemption of the Bonds, which notice shall specify, among other things, the redemption date, the redemption price, the place and manner of payment and that from the redemption date interest will cease to accrue on the Bonds which are the subject of such notice. Except as provided in the next sentence, notice of the redemption of Bonds will be given by first class mail, postage prepaid, or by facsimile transmission not less than 30 days prior to the redemption date, to the registered owners of the Bonds to be redeemed at their addresses as shown on the Bond Register. Prior to the date that the redemption notice is first given as aforesaid, funds shall be placed with the Trustee to pay such Bonds, any premium thereon, and accrued interest thereon to the redemption date, or (except in the case of a mandatory sinking fund redemption) such notice shall state that any redemption is conditional on such funds being deposited on the redemption date, and that failure to deposit such funds shall not constitute an Event of Default under the Indenture. Additional redemption notices will be provided to Bondholders who fail to present their Bonds in a timely manner as provided in the Indenture. Failure to give notice in the manner described above or a defect in the notice as to any Bond will not affect the validity of any proceedings for redemption as to any Bond for which notice is properly given. Interest will not accrue after the redemption date on any Bond called for redemption if notice has been given and if sufficient moneys have been deposited with the Trustee to pay principal of, premium, if any, and interest on such Bonds to the redemption date.

Bond Registration and Transfers

For a description of the procedure to transfer ownership of a Bond while in the book-entry only system, see “—Book-Entry Only System” below. Subject to the limitations described below, the Bonds are transferable upon surrender thereof at the principal corporate trust office of the Trustee, duly endorsed by, or accompanied by a written instrument or instruments of transfer in form satisfactory to, the Trustee and duly executed by the Bondholder or such Bondholder’s attorney duly authorized in writing. Subject to the limitations described below, any Bond may be exchanged at the principal corporate trust office of the Trustee upon surrender thereof, together with an assignment duly executed by the registered owner thereof or such registered owner’s attorney in such form and with guarantee of signature as shall be satisfactory to the Trustee for an equal aggregate principal amount of Bonds of like date and tenor of any Authorized Denomination as the Bonds surrendered for exchange bearing numbers not contemporaneously outstanding. The Trustee and the Board may charge a fee sufficient to cover any tax, fee or other governmental charge in connection with any exchange or transfer of any Bond (except in connection with any partial redemption thereof). Prior to a Term Rate Conversion Date or the Fixed Rate Conversion Date, the Trustee shall not be required to exchange or register the transfer of any Bonds after the mailing of notice calling such Bond for redemption has been made as provided in the Indenture, except that the Board and the Trustee shall be required to issue or register the transfer of Tendered Bonds after such date of mailing of notice or redemption.

Book-Entry Only System

General. The following information concerning DTC has been furnished by DTC for use in this Official Statement. Neither the Board nor the Underwriters are responsible for its accuracy or completeness.

DTC 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). One fully registered Bond certificate will be issued for each maturity of each Subseries of Bonds, 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, as amended. DTC holds and provides assets 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 participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between 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 ("NSCC"), Government Securities Clearing Corporation ("GSCC"), MBS Clearing Corporation ("MBSCC") and Emerging Markets Clearing Corporation ("EMCC") (NSCC, GSCC, MBSCC and EMCC are also subsidiaries of DTCC), as well as 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 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"). Direct Participants and Indirect Participants are collectively referred to as "Participants." DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities 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 Bond ("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, but beneficial owners are 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 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 Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of Bonds with DTC and their registration in the name of Cede & Co. effect no 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 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.

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

Beneficial owners of the 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, defaults and proposed amendments to the Bond documents. 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, or, in the alternative, beneficial owners may wish to provide their names and addresses to the Trustee and request that copies of notices be provided directly to them.

Neither DTC nor Cede & Co. will consent or vote with respect to the Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee 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 the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the payment date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payment date. 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, the Board or the Trustee, as applicable, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Board or the Trustee, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the beneficial owners is the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Board and the Trustee. Under such circumstances, if a successor securities depository is not obtained, certificates for the Bonds are required to be printed and delivered.

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

For every transfer and exchange of the Bonds, the Trustee and DTC and the DTC Participants will charge the beneficial owner a sum sufficient to cover any tax, fee or other governmental charge that may be imposed in relation thereto.

NEITHER THE BOARD NOR THE TRUSTEE HAS ANY RESPONSIBILITY OR OBLIGATION TO THE PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, CEDE & CO. OR ANY PARTICIPANT; THE PAYMENT BY DTC OR ANY PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR PURCHASE PRICE OF, PREMIUM, IF ANY, OR INTEREST

ON THE BONDS; ANY NOTICE WHICH IS PERMITTED OR REQUIRED TO BE GIVEN TO BENEFICIAL OWNERS UNDER THE INDENTURE; THE SELECTION BY DTC OR ANY PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE BONDS; OR ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC.

Effect on Bonds of Discontinuance of Book-Entry System

The following three paragraphs apply to the Bonds when not in the Book-Entry System:

Principal of Bonds bearing interest at a Weekly Rate, a Term Rate, a Flexible Rate or an Auction Rate will be payable upon the presentation and surrender thereof at the principal corporate trust office of the Trustee. The purchase price of Bonds upon optional or mandatory tender will be payable upon the presentation and surrender thereof at the principal corporate trust office of the Trustee's Agent or at such other office as may be designated by the Trustee.

Payment of interest on Bonds bearing interest at a Weekly Rate or a Term Rate is payable by a check mailed on the applicable Interest Payment Date to the registered owner thereof as of the close of business of the Trustee on the Record Date at the address of such owner as it appears on the Bond Register or at such other address as is furnished to the Trustee in writing by such owner not later than the Record Date. Payment of interest on Bonds bearing interest at a Flexible Rate or an Auction Rate shall be made to the registered owner thereof as of the close of business of the Trustee on the Record Date upon presentation and surrender of such Bonds at the principal corporate trust office of the Trustee on the applicable Interest Payment Date. Payment of interest on any Bonds shall be made to any registered owner of \$1,000,000 or more aggregate principal amount of Bonds as of the close of business of the Trustee on the Record Date for a particular Interest Payment Date by wire transfer to such registered owner on such Interest Payment Date upon written notice from such registered owner containing the wire transfer address within the United States of America to which such registered owner wishes to have such wire directed, which written notice is received not later than the Business Day next preceding the Record Date, provided that such wire transfer only shall be made for Bonds bearing interest at the Flexible Rate, upon presentation and surrender of such Bonds at the principal corporate trust office of the Trustee on the applicable Interest Payment Date.

Notwithstanding the foregoing, payment of Defaulted Interest on Bonds will be made to the persons who shall be the registered owners thereof on the Special Record Date fixed by the Trustee which shall be not more than 15 or less than 10 days prior to the date of the proposed payment of such Defaulted Interest, which shall not be less than 10 days after receipt by the Trustee of the notice of the proposed payment.

Estimated Sources and Uses of Funds

The following table shows the estimated sources and uses of funds in connection with the issuance of the aggregate principal amount of the Bonds:

<u>Sources:</u>	
Proceeds of the Bonds.....	\$257,925,000
Board Deposit	<u>16,000,000</u>
Total Sources of Funds	<u>\$273,925,000</u>
<u>Uses:</u>	
Deposit to the Project Fund.....	\$249,637,635
Deposit to Pledged State Aid Revenues Account ⁽¹⁾	16,000,000
Deposit to Interest Deposit Sub-Account ⁽²⁾	2,171,367
Deposit to Swap Payment Reserve Account ⁽³⁾	3,000,000
Costs of Issuance ⁽⁴⁾	<u>3,115,998</u>
Total Uses of Funds	<u>\$273,925,000</u>

- (1) Represents the full amount of the Board Deposit which is sufficient to pay interest on the Bonds from March 2, 2004 to and including March 1, 2005.
- (2) Represents capitalized interest which is sufficient to pay interest on the Bonds to and including March 1, 2004.
- (3) See “—Interest Rate Swap Agreements” below.
- (4) Includes bond insurance premium, Underwriter’s discount and other costs of issuance.

Interest Rate Swap Agreements

The Bonds will bear interest initially in the Auction Rate Mode. On the date of issuance of the Bonds, the Board will enter into two interest rate swap agreements (the “Swap Agreements”) with Lehman Brothers Special Financing Inc., and Lehman Brothers Inc. as guarantor (“Lehman Brothers”), and with Goldman Sachs Capital Markets, L.P., and Goldman Sachs Group, Inc. as guarantor (“Goldman Sachs,” and together with Lehman Brothers, the “Initial Swap Providers”). The Swap Agreements will be effective on the date of issuance of the Bonds and mature on March 1, 2034. Under the Swap Agreements, the Swap Providers will agree to pay a variable rate of interest and the Board will agree to pay a fixed rate of interest on a notional principal amount equal to \$95,350,000 for the Lehman Brothers swap and \$90,000,000 for the Goldman Sachs swap. The \$185,350,000 aggregate notional amount for the swaps represents the principal amount of the Series 2003D-3 Bonds, the Series 2003D-4 Bonds and a portion of the Series 2003D-2 Bonds (the “Swapped Bonds”). The notional amounts under the Swap Agreements decline by the same amount of the associated principal amortization of the Swapped Bonds.

The Board is entering into the Swap Agreements as a means of (1) lowering its borrowing costs when compared to fixed-rate bonds at the time of issuance and (2) limiting interest rate risk inherent in variable rate debt.

The swaps may expose the Board to certain risks. Should the market value of the swaps become positive, the Board may be exposed to the credit risk of the Swap Providers. If a Swap Provider’s credit rating from Standard & Poor’s and/or Moody’s Investors Service declines below specified rating levels and the market value of the swap reaches certain threshold amounts, the market value of the swap will be collateralized by the Swap Provider with U.S. government securities. Collateral would be posted with a third-party custodian. The current credit ratings for Lehman Brothers are “A+” and “A1” from Standard & Poor’s and Moody’s, respectively. The current credit ratings for Goldman Sachs are “A+” and “Aa3” from Standard & Poor’s and Moody’s, respectively.

The Board will be exposed to “basis risk” should the rate paid on the Swapped Bonds exceed the rate payable to the Board pursuant to the Swap Agreements. Should any adverse basis differential occur

while the Swap Agreements are in effect, the rate paid on the Swapped Bonds will be higher than the synthetic fixed rate, and therefore the expected interest cost savings may not be realized. The Board will fund a reserve of \$3 million for deposit into the Swap Payment Reserve Account (which is held by the Trustee under the Indenture but not pledged to the payment of the Bonds) to provide for the cost of the potential basis differential. See “THE BONDS—Estimated Sources and Uses of Proceeds.”

The Board may terminate the Swap Agreements at any time at market value. In addition, the Board or the Swap Providers may terminate the Swap Agreements if the other party fails to perform under the terms of the contracts. The Swap Agreements may also be terminated by the Board if the Swap Providers’ credit ratings from Standard & Poor’s, Fitch and/or Moody’s decline below specified rating levels. The Swap Agreements may also be terminated by the Swap Providers if the Board’s credit rating from Standard & Poor’s, Fitch and/or Moody’s decline below specified rating levels. If the Swap Agreements are terminated, the Swapped Bonds would no longer carry a synthetic fixed interest rate, and the Board would be subject to the interest rate risk associated with variable rate debt. Also, if at the time of termination the Swap Agreements have a negative market value, the Board could be liable to the Swap Providers for payment equal to the swap’s market value.

The Swap Payments to be made by the Board to the Swap Providers are payable from the Pledged State Aid Revenues and Pledged Taxes on a subordinate basis to the Bonds. See “SECURITY FOR THE BONDS—Payment of Debt Service on the Bonds and Swap Payments.”

SECURITY FOR THE BONDS

General

The Bonds will be issued pursuant to the School Code, the Debt Reform Act, the Resolutions and the Indenture. The Bonds will be general obligations of the Board to the payment of which the Board will pledge its full faith and credit, and will be payable, both as to principal and interest, from any moneys, revenues, receipts, income, assets or funds of the Board legally available for such purpose.

The Bonds will be payable from and secured by a pledge of (i) that amount of the General State Aid payments to be made to the Board in any year pursuant to Article 18 of the School Code, or such successor or replacement fund or act as may be enacted in the future, not in excess of \$75,000,000 in any year, as shall provide for the payment of the Bonds, and the provision of not less than an additional .25 times debt service on the Bonds (the “Pledged State Aid Revenues”), (ii) the ad valorem taxes levied against all of the taxable property in the School District without limitation as to rate or amount, and pledged under the Indenture as security for the Bonds (the “Pledged Taxes”), (iii) all Funds, Accounts and Sub-Accounts established pursuant to the Indenture with the exception of the Bond Purchase Fund, the Program Expense Fund and the Swap Payment Reserve Account, and (iv) any and all other moneys, securities and property furnished from time to time to the Trustee, by the Board or on behalf of the Board or by any other persons, to be held by the Trustee under the Indenture. As to the lien on the Pledged State Aid Revenues, the Bonds will be payable on a parity basis with any Additional Bonds. As described herein, the Pledged Taxes will be collected only as and to the extent that the Pledged State Aid Revenues are not available in sufficient amounts to pay the debt service on the Bonds and Swap Payments.

As described more fully below under “Payment of Debt Service on the Bonds and Swap Payments,” the Swap Payments required to be made by the Board to Swap Providers are payable from the Pledged State Aid Revenues on a subordinate basis to the Bonds.

As described above under “INTRODUCTION—Other State Aid Obligations,” the Board has also authorized the issuance of certain obligations payable from the Prior Authorization Revenues which

obligations do not have a claim on the Pledged State Aid Revenues. The Bonds are not secured by the Prior Authorization Revenues.

Pursuant to the 2002 Authorization, in September 2002 the Board issued its Series 2002A Bonds in the original aggregate principal amount of \$48,970,000. The Series 2002A Bonds are payable from alternate revenue sources other than the Pledged State Aid Revenues. The Series 2002A Bonds are the only issuance of Alternate Bonds under the 2002 Authorization. No Alternate Revenue Bonds payable from the Pledged State Aid Revenues have been issued under the 2002 Authorization.

The scheduled payment of principal of and interest on the Bonds when due will be guaranteed under the Policy to be issued concurrently with the issuance of the Bonds by the Bond Insurer. For additional information, see “BOND INSURANCE.”

General State Aid

General State Aid (“GSA”) represents the major portion of state support for Illinois public elementary and secondary schools. GSA is not targeted or categorical in nature, but may generally be expended at the discretion of the local school districts. However, the School Code requires the Board to dedicate a minimum of \$261.0 million from its GSA revenue to supplemental programs in the Supplemental General State Aid Fund (formerly known as State Chapter One Fund) for children from low-income families.

GSA consists of a regular foundation formula claim, as explained below, and a low-income student grant. The calculation of the regular foundation claim depends primarily upon a district’s best three months’ average daily attendance and local resources, such as equalized assessed valuation of property and corporate personal property replacement tax revenues within the school district. The low-income student grant provides additional resources for school districts that have a high concentration of low-income pupils. The low-income eligible pupil count came from the most recently available federal census through fiscal year 2003. In May 2003, the General Assembly adopted a new poverty grant formula. Instead of the most recent federal census poverty data, a new poverty count prepared by the Illinois Department of Human Services is used, starting in fiscal year 2004. The fiscal year 2004 count will be an average of the 2001 and 2002 count of children who are eligible for assistance under Medicaid, Kidcare, Food Stamps, or Temporary Assistance for Needy Families.

The GSA formula used through fiscal year 1998 provided for different methods of allocation, depending primarily upon the equalized assessed valuation of property within a school district’s boundaries. The amount of GSA distributed to school districts was determined by the annual State appropriation.

The GSA formula was significantly amended in 1997 (the “1997 Amendments”). As a result, the minimum or “foundation level” of GSA per pupil was increased from \$3,132 in fiscal year 1998 to \$4,225 in fiscal year 1999, \$4,325 in fiscal year 2000, \$4,425 in fiscal year 2001, \$4,560 in fiscal year 2002, and remained at \$4,560 in fiscal year 2003. The foundation level for fiscal year 2004 was \$4,810 per pupil, an increase of \$250 over the fiscal year 2003 level. In subsequent years, this “foundation level” will be set by the General Assembly, with advice from a funding advisory board.

Legislation adopted in 1999 by the General Assembly increases GSA funding for school districts that would otherwise experience a decrease in this funding because of increases in equalized assessed valuation of real property. In addition, the General Assembly increased the per pupil amount of the low-income student grant for low-income students, which is based on the low-income student count prepared by the Bureau of Census. As a result, the per pupil amount of the low-income student grant that applies

to the Board was \$1,243 for fiscal year 2000, \$1,273 for fiscal year 2001, \$1,333 for fiscal year 2002 and \$1,362 for fiscal year 2003.

The following chart sets forth the total GSA allocated to the Board for each of the fiscal years 1994 through 2003, the required contributions for Supplemental General State Aid allocations to individual schools, and the net amount available for deposit into the General Fund.

GENERAL STATE AID
Fiscal Years 1994 - 2004
(Dollars in Millions)

Fiscal Year	Total GSA Claim⁽¹⁾	Supplemental General State Allocation	Unrestricted GSA General Fund Deposit⁽²⁾
1994	453.6	248.9	204.4
1995	485.6	260.5	224.5
1996	501.7	261.6	240.1
1997	503.3	261.2	242.1
1998	567.7	261.2	306.5
1999	706.2	261.3	444.9
2000	711.1	261.0	450.1
2001	730.4	261.0	469.4
2002	801.8	261.0	540.8
2003	768.1	261.0	507.1
2004 (preliminary)	840.7	261.0	579.7

(1) Source: Illinois State Board of Education. Net of Illinois State Board of Education audit adjustments.

(2) Reflects moneys available to fund Pledged State Aid Revenues, the 1997 Authorization Revenues, the 1998 Authorization Revenues and the 2001 Authorization Revenues. Of such amount, a maximum of \$75,000,000 is pledged pursuant to the 2002 Authorization, a maximum of \$75,000,000 is pledged pursuant to the 2001 Authorization, a maximum of \$175,000,000 is pledged pursuant to the 1998 Authorization and a maximum of \$100,000,000 is pledged pursuant to the 1997 Authorization.

In calculating GSA, the State employs a formula consisting of a variety of variables, including one referred to as “available local resources.” One factor used in determining a school district’s available local resources is the amount of revenue that it derives from local property taxes. Consequently, the level of GSA in future years may be impacted by a number of factors, including increases in the aggregate real estate tax revenues that the Board may potentially derive from (i) changes in the equalized assessed valuation of property within the School District and (ii) the addition of new property to the School District’s tax base, as well as the determination of the School District’s operating tax rate in any given year.

Illinois law further specifies that whenever new property is added to a school district’s tax base, adjustments are to be made to that school district’s GSA. As of today, as a general matter, under the law, the Board will experience a \$3 decrease in GSA for every \$100 of adjusted equalized assessed valuation resulting from the addition of new property to its tax base (the “New AEAV”). However, given the Board’s current operating tax rate, the Board could offset this decrease and receive approximately \$4 in additional real estate taxes for every \$100 of New AEAV, provided that the Board elects to apply its full, current operating tax rate to the New AEAV in the year in which it becomes available.

In particular, a number of tax increment financing areas (the “TIFs”) established by the City of Chicago (the “City”) in prior years are expected to begin to terminate, commencing in 2007. As these TIFs terminate, the New AEAV resulting from their termination will become part of the School District’s tax base with respect to which the Board will be entitled to levy its then current operating tax rate. As

described above, the addition of the New AEA from an expiring TIF to the School District's tax base will cause a reduction in GSA, but this reduction can be offset by increased real estate tax revenues.

The Board does not anticipate that any future reductions in GSA resulting from New AEA will impact the Board's ability to collect the Pledged State Aid Revenues in amounts sufficient to meet its debt service obligations and debt service coverage covenants with respect to the Bonds.

Pledged Taxes

The Board has levied the Pledged Taxes to satisfy the debt service on the Bonds if pledged revenues are insufficient. The Pledged Taxes are ad valorem taxes levied against all of the taxable property in the School District, without limitation as to rate or amount. However, based on projected receipts of Pledged State Aid Revenues, the Board anticipates that all Pledged Taxes will be abated. To the extent that the Pledged State Aid Revenues are not available in sufficient amounts, the debt service on the Bonds is payable from the Pledged Taxes. In the event the Pledged Taxes are extended for collection, the Board will direct the County Collectors to segregate from each distribution of property taxes to be paid to the Board that percentage attributable to the levy of the Pledged Taxes for the payment of the debt service on the Bonds, and that amount will be paid directly to the Trustee for application in accordance with the provisions of the Indenture. The Board has covenanted in the Indenture to take all actions necessary to cause the levy and extension of additional Pledged Taxes in excess of those previously levied if necessary to pay debt service on the Bonds and Swap Payments. For additional information concerning the levy and collection of the Pledged Taxes, see "THE REAL PROPERTY TAX SYSTEM—Tax Levy—Collection."

Debt Service Funds and Accounts

The Indenture establishes the Debt Service Fund as a separate fund pledged to the payment of debt service on the Bonds. The Indenture also establishes five separate accounts in the Debt Service Fund, known as the "Pledged State Aid Revenues Account," the "Pledged Taxes Account," the "Bond Payment Account," the "Swap Payment Account" and the "Swap Payment Reserve Account" (which account is not pledged to the payment of the Bonds). The Pledged State Aid Revenues Account consists of the Deposit Sub-Account and the Payment Sub-Account, which Payment Sub-Account further consists of the Interest Deposit Sub-Account and the Pledged State Aid Revenues Sub-Account. The Bond Payment Account consists of the Interest Sub-Account and the Principal Sub-Account.

The Trustee will deposit to the credit of the Interest Deposit Sub-Account (i) any amounts paid by the Board to the Trustee from time to time with instructions for deposit into such Sub-Account, including such portion of the Initial Board Funds deposited by the Board upon the delivery of the Bonds, (ii) any payments made by the Swap Providers under the Swap Agreements, and (iii) amounts transferred from the Swap Payment Reserve Account. Amounts so deposited to the credit of the Interest Deposit Sub-Account will be transferred to the Interest Sub-Account and applied to pay interest on the Bonds as it becomes due on each Interest Payment Date as described below under "Payment of Debt Service on the Bonds and Swap Payments."

Application of Pledged State Aid Revenues; Abatement of Pledged Taxes

On or before February 15 of each year, or such earlier date as may be necessary to permit the Board to lawfully make the abatement of the Pledged Taxes described below (each such date being referred to as a "Deposit Date"), the Board shall deposit to the credit of the Pledged State Aid Revenues Account such amounts derived from Pledged State Aid Revenues as shall be necessary to cause the amount on deposit in said Account to equal the then-applicable Pledged State Aid Revenues Account Requirement.

The Pledged State Aid Revenues Account Requirement is determined as follows:

- (i) on each Deposit Date, with respect to the Bonds bearing interest at a Short Rate or an ARS Rate, an amount equal to the sum of (A) one year's interest on such Bonds based upon the aggregate principal amount of such Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and an interest rate equal to the greater of (x) 5% or (y) the actual weighted average interest rate borne by such Bonds for the 12-month period ending on the preceding February 1; *provided* that such amount shall be increased or decreased, as appropriate, giving effect to the known interest to accrue with respect to any Bonds in the Flexible Mode or the Auction Rate Mode on such Deposit Date from the first day of the next succeeding Bond Year to the Interest Payment Date for such Bonds; *provided, however*, that for any period of time during the next succeeding Bond Year for which a Swap Agreement is in place with respect to any Bonds requiring the Board to pay a fixed rate of interest, such amount shall be increased or decreased, as appropriate, giving effect to the known fixed rate of interest to accrue with respect to such Swap Agreement for such period of time during the next succeeding Bond Year that such Swap Agreement shall be in effect, (B) if no Swap Agreement is in place, the known interest to accrue with respect to any Bonds in the Flexible Mode or the Auction Rate Mode on such Deposit Date for which the Interest Payment Date occurs in the next succeeding Bond Year from the first day of the Rate Period for such Bonds to the last day of the then-current Bond Year, and (C) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year;
- (ii) on each Deposit Date, with respect to Bonds bearing interest at a Term Rate or Fixed Rate, an amount equal to the sum of (A) one year's interest on such Bonds based upon the aggregate principal amount of Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and the actual Term Rate or Fixed Rate or Term Rates or Fixed Rates then borne by such Bonds; *provided, however*, that for any period of time during the next succeeding Bond Year for which a Swap Agreement is in place with respect to any Bonds requiring the Board to pay a variable rate of interest, such amount shall be increased or decreased, as appropriate, by calculating interest with respect to such Bonds pursuant to subparagraph (i)(A) above, treating the Swap Agreement as the Bonds for purposes of subclause (y), above, and (B) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year; and
- (iii) on each Deposit Date, with respect to any Bank Bonds, an amount equal to the sum of (A) one year's interest on such Bank Bonds based upon the aggregate principal amount of such Bank Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and an assumed interest rate equal to the greater of (i) 8.00% or (ii) the average Bank Rate for the 12-month period ending on the preceding February 1 (regardless of whether Bank Bonds are Outstanding during such period) and (B) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year.

Once such deposit has been made satisfying the then-applicable Pledged State Aid Revenues Account Requirement, the Board shall, pursuant to the Indenture, take such actions as are necessary to abate in full the Pledged Taxes levied to otherwise provide funds for the payment of the debt service on the Bonds.

In the event that on any Deposit Date there has been deposited to the credit of the Pledged State Aid Revenues Account an insufficient amount to satisfy the then-applicable Pledged State Aid Revenues Account Requirement, the Board shall, pursuant to the Indenture, take such actions as are necessary to cause the extension of the Pledged Taxes levied for the calendar year next preceding the calendar year of such Deposit Date in an amount sufficient, when added to the amount then on deposit in the Pledged State Aid Revenues Account, to provide the funds necessary to satisfy such Pledged State Aid Revenues Account Requirement. The Board has covenanted in the Indenture to take all action necessary to cause the levy and extension of additional Pledged Taxes in excess of those previously levied to pay debt service of the Bonds.

If at any time while the Bonds bear interest at a Short Rate, an ARS Rate or the Bank Rate, the amount on deposit in the Pledged State Aid Revenues Sub-Account shall be insufficient to provide for the payment in full of (i) the principal of and interest on the Bonds and (ii) the Swap Payments to become due during the then-current Bond Year, the Board shall promptly deposit moneys derived from Pledged State Aid Revenues into the Pledged State Aid Revenues Sub-Account in such amounts as shall be necessary to cause the amount on deposit in the Pledged State Aid Revenues Sub-Account to be sufficient to pay (x) the interest to accrue on the Bonds for the remainder of the then-current Bond Year based on the aggregate principal amount of Bonds then Outstanding and an assumed interest rate equal to the average rate on the Bonds for the period commencing on March 2 of the then-current Bond Year and ending on the Business Day immediately preceding such date of calculation, (y) the principal amount of Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the then-current Bond Year and (z) the Swap Payments scheduled to become due during the then-current Bond Year.

Payment of Debt Service on the Bonds and Swap Payments

The Trustee shall transfer first from moneys on deposit in the Pledged Taxes Account, second from moneys on deposit in the Interest Deposit Sub-Account, and last from moneys on deposit in the Pledged State Aid Revenues Sub-Account (i) to the Interest Sub-Account of the Bond Payment Account on or before each Interest Payment Date for any of the Outstanding Bonds, the amount required for the interest payable on such date, less the amount then on deposit in the Interest Sub-Account and available for such payment; (ii) to the Principal Sub-Account of the Bond Payment Account on or before each March 1, an amount equal to the principal amount of the Outstanding Bonds, if any, which mature on such date; and (iii) to the Principal Sub-Account of the Bond Payment Account on or before each March 1 on which Bonds are subject to mandatory sinking fund redemption pursuant to the Indenture, the amount required for the payment of the Redemption Price of such Outstanding Bonds then to be redeemed.

After deducting the amount required to be transferred to the Principal Sub-Account on the next succeeding March 1 and provided the Board is not in default with respect to the payment of interest on the Bonds, there shall be transferred into the Swap Payment Account on each March 1 and September 1, or such other dates specified in the Swap Agreements which the Board shall identify in a written notice delivered to the Trustee (each, a "Swap Payment Date") first from moneys on deposit in the Pledged Taxes Account, second from moneys on deposit in the Interest Deposit Sub-Account, and last from the Pledged State Aid Revenues Sub-Account, an amount equal to the sum of the Swap Payments then owing under the Swap Agreements on such Swap Payment Date. The Trustee shall pay each Swap Provider on each Swap Payment Date from amounts then on deposit in the Swap Payment Account pursuant to payment instructions specified in the relevant Swap Agreements and provided to the Trustee and the Board by such Swap Provider. On or prior to March 1, 2004 and each March 1 thereafter, the Board shall provide the Trustee with written notice of the amount of each Swap Payment owing to such Swap Provider on each Swap Payment Date for the succeeding Bond Year. The Board shall promptly notify the Trustee in writing if the amount of any Swap Payment shall change from the amount identified in such

notice. Notwithstanding anything in the Indenture to the contrary, all payments of Swap Payments to be paid from Pledged Taxes shall be subordinate to the payment of principal of and interest on the Bonds and all payments of Swap Payments to be paid from Pledged State Aid Revenues shall be subordinate to the payment of principal of and interest on the Bonds and any Additional Bonds.

All amounts on deposit in the Pledged State Aid Revenues Sub-Account (excluding amounts held in the Swap Payment Reserve Account) on March 1 of each year, following the transfers required to be made to the Bond Payment Account and the Swap Payment Account, shall be withdrawn from said Sub-Account and paid to the Board free and clear of the lien of the Indenture.

Bond proceeds in the amount of \$3,000,000 shall be initially deposited to the Swap Payment Reserve Account. From time to time, the Board may deposit to the Swap Payment Reserve Account additional amounts. Amounts in the Swap Payment Reserve shall be transferred to the Interest Deposit Sub-Account at the direction of the Board. The Board retains the sole and exclusive right to use, increase, decrease or eliminate the amount of money held in the Swap Payment Reserve Account.

Pledge of Funds, Accounts and Sub-Accounts

In addition to the Pledged State Aid Revenues and the Pledged Taxes, all Funds, Accounts and Sub-Accounts established pursuant to the Indenture are pledged to the payment of the Bonds except the Bond Purchase Fund, the Program Expense Fund and the Swap Payment Reserve Account. A subordinate lien is granted to the Swap Providers under the Indenture on amounts on deposit from time to time in the Swap Payment Account. See APPENDIX-B—“SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

Additional Obligations Payable From Pledged State Aid Revenues

The Board may issue Additional Bonds from time to time payable from all or any portion of the Pledged State Aid Revenues or Pledged Taxes or any other source of payment which may be pledged under the Debt Reform Act; provided, however, that no Additional Bonds may be issued except in accordance with the provisions of the Debt Reform Act as in existence on the date of issuance of the Additional Bonds. Subject only to compliance with such provisions of the Debt Reform Act, there is no limit on the aggregate principal amount of Additional Bonds, which may be issued by the Board. For additional information, see “CAPITAL IMPROVEMENT PROGRAM—Future Financings.”

The Board reserves the right to issue bonds or other evidences of indebtedness payable from the Pledged State Aid Revenues and/or from the Pledged Taxes, which are subordinate to the Bonds. Such subordinate obligations will be paid from such Pledged State Aid Revenues and/or Pledged Taxes available to the Board in each year in excess of those required to be deposited in the Funds and Accounts established under the Indenture.

Bonds Are Obligations of the Board

The Bonds are the direct and general obligations of the Board to the payment of which the Board has pledged its full faith and credit and taxing power. The Bonds are not the obligations of the City, the State or any other political subdivision of the State (other than the Board). Neither the full faith and credit nor the taxing power of the City, the State or any other political subdivision of the State (other than the Board) is pledged to the payment of the Bonds.

Rights of the Bond Insurer

The Indenture grants the Bond Insurer certain approval, consent and waiver rights with respect to certain actions that the Board and the Owners are authorized to take under the Indenture. See APPENDIX-B—“SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.”

BOND INSURANCE

The following information has been supplied by the Bond Insurer for inclusion in this Official Statement. No representation is made by the Board or the Underwriters as to the accuracy or completeness of the information.

Upon the issuance of the Bonds, XL Capital Assurance Inc. (the “Bond Insurer” or “XLCA”) will issue three separate financial guaranty insurance policies (the “Policies”) that will guarantee the payment of scheduled principal of and interest on the Series 2003D-2 Bonds, the Series 2003D-3 Bonds and the Series 2003D-4 Bonds (collectively referred to herein as the “Insured Bonds”).

The Bond Insurer will not guarantee, and the Policies do not cover, payment of principal of or interest on the Series 2003D-1 Bonds.

The Bond Insurer accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Bond Insurer and its affiliates set forth under this heading. In addition, the Bond Insurer makes no representation regarding the Bonds or the advisability of investing in the Bonds.

General

The Bond Insurer is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. The Bond Insurer is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, the State of New York, forty-seven other states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Singapore. The Bond Insurer has license applications pending, or intends to file an application, in each of those states in which it is not currently licensed.

The Bond Insurer is an indirect wholly owned subsidiary of XL Capital Ltd, a Cayman Islands corporation (“XL Capital Ltd”). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance and reinsurance coverages and financial products to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The common stock of XL Capital Ltd is publicly traded in the United States and listed on the New York Stock Exchange (NYSE: XL). **XL Capital Ltd is not obligated to pay the debts of or claims against the Bond Insurer.**

The Bond Insurer was formerly known as The London Assurance of America Inc. (“London”), which was incorporated on July 25, 1991 under the laws of the State of New York. On February 22, 2001, XL Reinsurance America Inc. (“XL Re”) acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

Reinsurance

The Bond Insurer has entered into a facultative quota share reinsurance agreement with XL Financial Assurance Ltd (“XLFA”), an insurance company organized under the laws of Bermuda, and an affiliate of the Bond Insurer. Pursuant to this reinsurance agreement, the Bond Insurer expects to cede up to 90% of its business to XLFA. The Bond Insurer may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by the Bond Insurer as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit the Bond Insurer’s obligations under any financial guaranty insurance policy. With respect to any transaction insured by XLCA, the percentage of risk ceded to XLFA may be less than 90% depending on certain factors including, without limitation, whether XLCA has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XLCA, including the Policies.

Based on the audited financials of XLFA, as of December 31, 2002, XLFA had total assets, liabilities, redeemable preferred shares and shareholders’ equity of \$611,791,000, \$245,750,000, \$39,000,000 and \$327,041,000, respectively, determined in accordance with generally accepted accounting principles in the United States. XLFA’s insurance financial strength is rated “Aaa” by Moody’s and “AAA” by S&P and Fitch Inc. In addition, XLFA has obtained a financial enhancement rating of “AAA” from S&P.

The obligations of XLFA to the Bond Insurer under the reinsurance agreement described above are unconditionally guaranteed by XL Insurance (Bermuda) Ltd (“XLI”), a Bermuda company and one of the world’s leading excess commercial insurers. XLI is a wholly owned indirect subsidiary of XL Capital Ltd. In addition to having an “A+” rating from A.M. Best, XLI’s financial strength rating is “Aa2” by Moody’s and “AA” by Standard & Poor’s and Fitch. The ratings of XLFA and XLI are not recommendations to buy, sell or hold securities, including the Insured Bonds and are subject to revision or withdrawal at any time by Moody’s, Standard & Poor’s or Fitch.

Notwithstanding the capital support provided to the Bond Insurer described in this section, the Owners of the Insured Bonds will have direct recourse against the Bond Insurer only, and neither XLFA nor XLI will be directly liable to the Owners of the Insured Bonds.

Financial Strength and Financial Enhancement Ratings of XLCA

The Bond Insurer’s insurance financial strength is rated “Aaa” by Moody’s and “AAA” by Standard & Poor’s and Fitch, Inc. (“Fitch”). In addition, XLCA has obtained a financial enhancement rating of “AAA” from Standard & Poor’s. These ratings reflect Moody’s, Standard & Poor’s and Fitch’s current assessment of the Bond Insurer’s creditworthiness and claims-paying ability as well as the reinsurance arrangement with XLFA described under “Reinsurance” above.

The above ratings are not recommendations to buy, sell or hold securities, including the Insured Bonds, and are subject to revision or withdrawal at any time by Moody’s, Standard & Poor’s or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the Insured Bonds. The Bond Insurer does not guaranty the market price of the Insured Bonds nor does it guaranty that the ratings on the Insured Bonds will not be revised or withdrawn.

Capitalization of the Bond Insurer

Based on the audited statutory financial statements for XLCA as of December 31, 2001, XLCA had total admitted assets of \$158,442,157, total liabilities of \$48,899,461 and total capital and surplus of

\$109,542,696 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities (“SAP”). Based on the audited statutory financial statements for XLCA as of December 31, 2002 filed with the State of New York Insurance Department, XLCA has total admitted assets of \$180,993,189, total liabilities of \$58,685,217 and total capital and surplus of \$122,307,972 determined in accordance with SAP.

For further information concerning XLCA and XLFA, see the financial statements of XLCA and XLFA, and the notes thereto, incorporated by reference in this Official Statement. The financial statements of XLCA and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the “Commission”) by XL Capital Ltd and may be reviewed at the EDGAR website maintained by the Commission. All financial statements of XLCA and XLFA included in, or as exhibits to, documents filed by XL Capital Ltd pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 on or prior to the date of this Official Statement, or after the date of this Official Statement but prior to termination of the offering of the Insured Bonds, shall be deemed incorporated by reference in this Official Statement. Except for the financial statements of XLCA and XLFA, no other information contained in XL Capital Ltd’s reports filed with the Commission is incorporated by reference. Copies of the statutory quarterly and annual statements filed with the State of New York Insurance Department by XLCA are available upon request to the State of New York Insurance Department.

Regulation of the Bond Insurer

The Bond Insurer is regulated by the Superintendent of Insurance of the State of New York. In addition, the Bond Insurer is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, the Bond Insurer is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. The Bond Insurer is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York and most other jurisdictions have laws and regulations prescribing permitted investments and governing the payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

THE FINANCIAL GUARANTY INSURANCE POLICIES ISSUED BY THE BOND INSURER, INCLUDING THE POLICIES, ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

The principal executive offices of the Bond Insurer are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478-3400.

BOARD OF EDUCATION OF THE CITY OF CHICAGO

General

The Board is a body politic and corporate and a school district of the State (the “School District”), having boundaries coterminous with the boundaries of the City. The Board is established under and governed by the School Code. The Board is not a home rule unit of government.

The Board maintains the system of public schools within the City primarily for grades kindergarten through 12. Responsibility for the governance of the Board and policy-making for the public school system is currently vested in the seven-member Chicago Board of Education (the “School Board”). In addition, elected local school councils, composed of parents, teachers, principals and community representatives, exercise certain powers relating to the operation of individual schools in the public school system, including selection of principals.

Governing Body

Pursuant to the provisions of Public Act 89-15, approved and effective May 30, 1995 (the “1995 Amendatory Act”), the then-existing 15-member Chicago Board of Education (the “Prior Board”) was replaced with the Chicago School Reform Board of Trustees of the Board of Education of the City of Chicago, Illinois (the “Reform Board of Trustees”). Under the 1995 Amendatory Act, the Reform Board of Trustees served as the governing board of the School District until June 30, 1999. On July 1, 1999, by operation of the 1995 Amendatory Act, the Reform Board of Trustees became the School Board. The members of the School Board were appointed by the Mayor of the City (the “Mayor”) and are listed below. The appointments to the School Board did not require approval of the City Council.

Under the School Code, the School Board is responsible for approving the annual budget, approving contracts (including collective bargaining agreements), levying real property taxes and establishing general policies of the Board. The current members of the School Board are as follows:

Michael W. Scott is President of the School Board. Mr. Scott is Vice President of Regulatory Affairs for Comcast Corporation. He is also a commissioner on the Public Building Commission of Chicago. He was formerly the Executive Director of the Lawndale People’s Planning and Action Conference, then Director of Community Development and ultimately, Vice President of Pyramidwest Development Corporation. He also has served under the late Mayor Harold Washington as Special Assistant to the Mayor, Director for the Mayor’s Office of Special Events, and Chief Cable Administrator for the City of Chicago’s Office of Communication. He is a former member of the Board and has chaired its committee on real estate. Mr. Scott currently serves on the board of directors for the Community Bank of Lawndale and for a number of civic and charitable organizations, including, among others, Mount Sinai Hospital, Better Boys Foundation and the Chicago Historical Society.

Norman R. Bobins is Chairman, President and Chief Executive Officer of LaSalle National Bank. He has also served as a Trustee of the Public School Teachers’ Pension and Retirement Fund of Chicago and is also a member of the Public Building Commission of Chicago. He received a Bachelor of Arts degree from the University of Wisconsin and a Master of Business Administration from the University of Chicago. He is a graduate of the Chicago Public Schools. Mr. Bobins is active in several civic organizations, including Chicago United.

Dr. Tariq Butt is Director of the Access Community Health Network. As part of his medical practice, Dr. Butt provides a range of medical services to patients on the west side of the City, regardless of their ability to pay. Dr. Butt is a native of Pakistan, where he received his medical training. He has also served as Chairman of the Mayor’s Advisory Council on Asian-American Affairs, a position from

which he resigned to serve on the School Board. Dr. Butt is currently serving as a member of the Board of Directors for the Illinois Association of School Boards.

Clare Munana is a public sector management and international consultant with over 15 years of domestic and international business experience. She was formerly a researcher at the Brookings Institute where she performed risk analysis of foreign markets. Ms. Munana is a graduate of Boston College, where she received her Bachelor of Arts degree in Political Science and Spanish Literature. She earned a Masters in International Economics and Politics from the School of Advanced International Studies of John Hopkins University and a Masters of Management from the Kellogg Graduate School of Management at Northwestern University. Ms. Munana recently completed a certification program at the Sorbonne-University of Paris in French Civilization and Language.

Gene R. Saffold is Managing Director and Head of Public Finance for Banc One Capital Markets, Inc. He also serves as a Trustee of the Public School Teachers' Pension and Retirement Fund of Chicago. He has previously held positions at Salomon Smith Barney, The First National Bank of Chicago and LS Financial Group. Mr. Saffold received a Bachelor of Arts degree from Carleton College in Minnesota and a Master of Business Administration degree from the University of Chicago Graduate School of Business. He is a graduate of the Chicago Public Schools. Mr. Saffold is active in several civic organizations, including the Civic Federation of Chicago.

Alberto A. Carrero, Jr. is Senior Vice President and Public Banking Manager of Banco Popular North America ("Banco Popular"), the country's largest Hispanic-owned bank. In addition to his regional duties, Mr. Carrero is also a member of Banco Popular's national team currently in charge of expanding the bank's services in government and public agencies at city, state and national levels. Prior to joining Banco Popular, Mr. Carrero worked for the Federal Deposit Insurance Company (FDIC) in the New York Region. He graduated from the University of Puerto Rico with a degree in Business Administration and Finance. Mr. Carrero is member of the Board of Trustees of the City Colleges of Chicago and has been the recipient of numerous awards from Illinois and New York City and State agencies for excellence in business.

The members of the School Board have been appointed to serve terms ending as follows:

Member	Term Expires
Michael W. Scott, President.....	June 30, 2003*
Norman R. Bobins	June 30, 2006
Dr. Tariq Butt.....	June 30, 2003*
Clare Munana.....	June 30, 2006
Gene R. Saffold.....	June 30, 2003*
Alberto A. Carrero, Jr.	June 30, 2006

* Members continue to hold office pursuant to Section 34-3(b) of the School Code, 105 ILCS 5/1 *et seq.*

At the expiration of the term of each member, the Mayor shall appoint a successor for a four-year term from July 1 of the year in which the term commences. Any vacancy shall be filled by appointment of the Mayor for the unexpired term. Currently, there is one vacancy on the School Board.

The School Board elects annually from its members a president and vice-president in such manner as the School Board determines.

Central Administration

As authorized under the School Code, the Board has established the following offices and appointed the following individuals to serve in the capacities indicated.

Chief Executive Officer	Arne Duncan
Chief Education Officer	Barbara Eason-Watkins
Chief Administrative Officer	David Vitale
Chief Operating Officer	Sean P. Murphy
Chief Financial Officer	John Maiorca
Chief Purchasing Officer	Heather A. Crossley-Obora
General Counsel	Ruth M. Moscovitch

Arne Duncan is the Chief Executive Officer of the Board. Mr. Duncan was formerly Deputy Chief of Staff for the previous Chief Executive Officer of the Board and, prior to that, directed the Ariel Education Initiative. He received a Bachelor of Arts degree in Sociology from Harvard University. Mr. Duncan serves on the boards of directors for the Ariel Education Initiative, The Children’s Center, City Year, the Illinois Council Against Handgun Violence and the South Side YMCA, and serves on the Visiting Committee for the University of Chicago’s School of Social Service Administration.

Barbara Eason-Watkins is the Chief Education Officer of the Board. Ms. Eason-Watkins is a nationally recognized school principal from Chicago’s Woodlawn community who has spent her entire 29-year professional career in the schools, working with students, teachers and parents. Since 1988, Ms. Eason-Watkins has been principal of McCosh Elementary School in Chicago. A native of Detroit, Michigan, she received a Bachelor’s degree in elementary education from the University of Michigan, a Masters degree in educational administration and supervision from Chicago State University, and a doctorate in education, with a specialty in curriculum and instruction, from Loyola University, Chicago.

David Vitale is the Chief Administration Officer of the Board, overseeing all of the educational support departments, including Finance, Budget, Operations, Human Resources, Technology, Security, Procurement and Business Diversity. In February of 2003, Mr. Vitale joined the Board as Senior Advisor to the Chief Executive Officer, on a full-time, pro-bono basis to improve efficiencies of the school system. Prior to joining the Board, Mr. Vitale served as President and Chief Executive Officer of the Chicago Board of Trade. In addition to serving as a member of the CBOT’s Board of Directors and Executive committee, Mr. Vitale also served as President and CEO of the MidAmerica Commodity Exchange, an affiliate of CBOT. Mr. Vitale is a graduate of Harvard University and earned an MBA from the University of Chicago.

Sean P. Murphy is the Chief Operating Officer of the Board. Prior to his current appointment, Mr. Murphy served as the Board’s Chief Purchasing Officer. Prior to his service with the Board, he served as Deputy Commissioner for the City’s Department of Aviation, acting as the Business Director for the O’Hare Modernization Program. Mr. Murphy also served as Deputy Procurement Officer for the City’s Department of Procurement Services. Prior to his service with the City, Mr. Murphy served for over 10 years with Raytheon Engineers and Constructors, Inc. and RR Donnelley in various procurement roles, up to and including Project Procurement Manager, executing design-build projects and strategic sourcing initiatives. Mr. Murphy received a Bachelor of Science degree in Mathematics from Colorado State University and a Masters of Business Administration from DePaul University.

John Maiorca is the Chief Financial Officer of the Board. Prior to his current appointment, he served as the Budget Director for the Board’s Office of Management and Budget. Prior to his service with the Board, Mr. Maiorca served as First Deputy Director for the City of Chicago’s Departments of Revenue and Office of Budget and Management. Mr. Maiorca received a Masters of Urban Planning degree from the City University of New York and a Bachelor of Arts from the City University of New York.

Heather A. Crossley-Obora is the Chief Purchasing Officer of the Board. Ms. Obora previously served as the Board’s Deputy Chief Financial Officer and Deputy Controller-Disbursements. Prior to

joining the Board, Ms. Obora was the Comptroller for the Clerk of the Circuit Court of Cook County, a Senior Tax Accountant for Crowe Chizek in Oak Brook, Illinois and a Senior Accountant for Barbich, Longcrier, Hooper & King, a public accounting firm in Bakersfield, California. Ms. Obora holds a BS in Business Administration with a Concentration in Accounting from California State University–Bakersfield.

Ruth M. Moscovitch is the General Counsel of the Board. Prior to her current appointment, Ms. Moscovitch served as an executive for Commonwealth Edison Co., and its parent Exelon Energy Delivery as Vice President, Labor Relations for the Nuclear Generation Group of ComEd and as Vice President for Strategic Initiatives for Exelon Energy Delivery. Prior to joining Commonwealth Edison Company, Ms. Moscovitch was the General Counsel for the City Colleges of Chicago. Ms. Moscovitch also served as a Chief in the Appeals and Litigation Divisions for the City of Chicago’s Department of Law. Ms. Moscovitch received her law degree from Northwestern University and her bachelor’s degree from Radcliffe College, Harvard University.

School System

The Chicago Public School system consists of 602 attendance centers consisting of 493 elementary schools, 95 high schools and 14 charter schools serving 438,589 children.

The following table presents the fall enrollment in the school system for the last five school years.

<u>School Year</u>	<u>Elementary School</u>	<u>High School</u>	<u>Combined</u>
2002/2003	337,525	101,064	438,589
2001/2002	338,445	99,173	437,618
2000/2001	339,281	96,189	435,470
1999/2000	336,631	95,119	431,750
1998/1999	335,539	95,546	431,085

Capital Improvement Program

The Board is currently implementing one of the largest school construction and rehabilitation programs in the nation. Initially adopted by the Board in 1996, the Capital Improvement Program is an ongoing plan of work, based on current projections of funding availability and project priorities. The Capital Improvement Program is organized around three basic and critical objectives: (a) reducing student density to no more than 80 percent of each elementary school’s design capacity to relieve severe overcrowding; (b) achieving a minimum level of physical condition and operating efficiency for each facility; and (c) improving the overall quality of the learning environment at each individual school. To achieve these objectives, the Capital Improvement Program is organized into three general program areas:

1. New construction, including new schools, additions, annexes and modular units;
2. Building renovation, including new windows, new roofs, masonry, science labs, gymnasiums, Americans with Disabilities Act improvements, energy efficiencies and information technology, including wiring and equipment to connect all Chicago Public Schools facilities to a wide area network; and
3. Educational enhancements, including new campus parks and playlots.

Program Management. The Board utilizes a broad-based priority system for structuring the Capital Improvement Program, including architectural assessments that categorize capital projects by need. To date, the Capital Improvement Program has addressed primarily the highest priority exterior

envelope projects such as windows, roofs and masonry work. With many of these projects completed or underway, the next phase will be addressing high priority, interior projects such as electrical and heating/air ventilation systems.

Coupled with the broad-based priority system, the Capital Improvement Program is re-evaluated annually to ensure that changing needs are incorporated into the program. For example, the Board annually updates space utilization reports to gauge current student overcrowding. To assess long-term classroom demand, the Board utilizes University of Illinois demographic forecasts. The Board also employs an aggressive preventative maintenance and evaluation program to (1) ensure that capital improvements are sustained through preventative measures and (2) provide an on-going capital needs assessment system-wide.

The Board uses third-party firms to provide program management services for the Capital Improvement Program to ensure appropriate oversight and cost control. In September 1998, the Board engaged Chicago School Associates, a joint venture of design, engineering, and construction firms, as program manager.

Summary of Work Performed and Expenditures. Since the program's inception, over 1,390 new permanent classrooms have been constructed, with more underway, increasing capacity to accommodate approximately 39,000 additional students. These new classrooms are distributed throughout 21 new schools, 8 replacement schools, 34 additions and 27 annexes. Additionally, 2,094 renovations have been completed to date including new roofs at 372 schools, new windows for 347 schools, and masonry work for 330 schools. Over 779 schools have their local area networks in place. The Board anticipates undertaking a similar number of renovation projects and installing local area networks in its remaining schools in the coming years. Finally, approximately 282 play lots and 16 athletic fields have been renovated to provide students with safe facilities for play and sports.

To finance the Capital Improvement Program, the Board has issued \$3.3 billion in aggregate principal amount of Alternate Bonds (excluding refunding bonds). As of September 1, 2003, approximately \$3.1 billion of proceeds have been spent, and substantially all of the net proceeds remaining have been "encumbered" (i.e., obligated for future expenditure on identified projects).

Projects Financed by the Bonds. The proceeds of the Bonds will be used to finance additional components of the Capital Improvement Program. The acquisition, construction, repair, renovation, rehabilitation and equipping of school facilities and sites financed with the proceeds of the Bonds will be implemented by the Board.

Future Financings. In addition to the Bonds, during fiscal year 2004, the Board may issue additional bonds to continue implementation of the Capital Improvement Program. Further, consistent with applicable provisions of State law, the Board has the authority to adopt additional authorizing resolution(s) under which some of these bonds may be issued.

Further, the Board anticipates that, subject to market conditions and other factors, it may issue one or more series of Alternate Bonds in addition to those described above to refund, at or prior to maturity, a portion of the debt service on the outstanding Alternate Bonds. Other types of debt obligations may also be used to provide the Board with funds for future implementation of certain components of the Capital Improvement Program.

Educational Reform Initiatives

Under Mayor Richard M. Daley's leadership, the Chicago Public School system ("CPS") has become a national model for urban education. School districts across the country, as well as foreign

nations, are turning to Chicago for lessons in making public education effective once again. In July 2001, Mayor Daley appointed a new management team consisting of experienced managers who have guided CPS over the past six years as well as new talent from the corporate, university, and nonprofit sectors. This team remains committed to enhancing the fundamental services efficiently and effectively provided to students and to bringing new vitality to CPS' educational programs.

Focus on Educational Goals. CPS has developed strategies that enhance educational opportunities and improve the academic skills of all CPS students. Working together with parents, community-based organizations, teachers, educators, and the elected officials of the Chicago Teachers Union, CPS' focus encompasses three areas: reading, teacher excellence, and community schools.

Reading Enhancement Action Plan. This top priority program focuses on teaching every student in every school to read. The program establishes a uniform instructional framework structured to provide continuity citywide at all grade levels. The program requires a minimum of two hours a day be devoted exclusively to reading and writing in every elementary school. At the high school level, double periods of reading and writing are required for students not at grade level. In addition, CPS is training an elite corps of reading specialists, recruited both locally and nationally, to ensure that teachers are trained to use books and materials appropriately.

Teacher Excellence. Rising student enrollments, an increasing number of teachers reaching retirement age, and a decreasing number of college students choosing a teaching career have led CPS to new initiatives to recruit and retain teachers. Teacher quality, one of the best predictors of student achievement, is being addressed through an initiative to ensure that all teachers are qualified and have appropriate certifications in all classrooms. Creating strong, nurturing environments that support teacher needs will further improve teacher classroom skills and drive student achievement.

Community Schools. Several CPS schools operate year-round and are open long hours to provide for the needs of the students before, during and after traditional school days. CPS' vision encompasses a comprehensive, coordinated and collaborative delivery of services jointly created and operated by the school, community organizations and parents as equal partners based on each school's needs. Programs currently offered include tutoring, art, sports and other enrichment activities designed to build on skills, talents and interests developed as part of the regular curriculum. By collaborating with community-based organizations already funded to provide social and health services to our students, schools can directly address the needs of children by providing services onsite.

Educational Results. There continue to be many positive educational trends at CPS. The 2003 results from the Iowa Test of Basic Skills show that 40.9 percent of elementary school students are reading at or above national norms, while 48.2 percent are performing at or above national norms in math. Overall, reading scores are up 14.4 percentage points and math 17.2 percentage points since 1996, the first full school year Mayor Daley assumed responsibility for the schools. Additionally, in high schools, the dropout rate declined, the graduation rate continued to grow, average ACT scores increased, and more students are taking advanced placement classes than ever before.

Chicago Teachers' Union and Other Employee Groups

For its 2004 fiscal year, the Board employed approximately 47,000 persons. Approximately 90% of the Board's employees are represented by six unions that engage in collective bargaining with the Board. As of September 1, 2003 approximately 74% of the Board's employees were represented by the Chicago Teacher's Union (the "CTU") and approximately 16% were represented by five other unions.

The Board's current four-year agreement with the CTU expires June 30, 2007. The contract provides for base salary increases for most teachers of 4% for each fiscal year through 2007. These amounts are subject to increase if the Board receives additional funding from certain sources.

The remaining five labor unions also hold four year contracts with the Board. All of these agreements expire on June 30, 2007. Employees represented by these unions will experience a base salary increase of 4% for each fiscal year through 2007.

The Board has sought certain methods of alternative dispute resolution to reduce the number of union grievances and overall labor litigation. A voluntary grievance mediation program, a labor management committee and a class size monitoring committee designed to resolve class size complaints successfully divert numerous matters away from litigation each year.

Other issues addressed in all collective bargaining agreements with the Board include various working conditions, grievance procedure and employee benefits. For a discussion of pension and retirement benefits for eligible employees, see "Employee Pension Obligations" below under this caption.

Recent Financial Information Concerning the Board

For fiscal years 1996 through 2003, the Board adopted and achieved a balanced budget. On June 25, 2003, the Board also adopted a balanced budget for fiscal year 2004 totaling approximately \$3.8 billion.

The most recent audited financial statements are for the fiscal year ended June 30, 2002 and are included as APPENDIX-A, including the unqualified report of independent public accountants dated November 22, 2002.

GASB No. 34. In June of 1999, GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* ("GASB No. 34"). The GASB No. 34 financial reporting model is mandatory for all state and local governments and dramatically changes the presentation and content of governments' external financial statements. GASB No. 34 required that the CPS implement the new reporting model no later than fiscal year 2002. The CPS implemented GASB No. 34 earlier than required for fiscal year 2001 reporting purposes.

General Operating Fund Balances. As of June 30, 2003, the Board had an estimated fund balance of \$326.9 million, of which \$124.7 million has been reserved for encumbrances and other specific purposes. The remaining unreserved balance was \$202.2 million, all of which was designated to provide operating capital. The approved fiscal year 2004 budget draws \$48.7 million from the fund balance. In addition, the fiscal year 2004 budget re-appropriated \$25.0 million of ending fiscal year 2003 fund balance as reserved for specific purposes. The amounts shown in the following table have been adjusted to reflect the estimated fiscal year end amount reserved for such purposes of \$20.8 million.

**General Operating Fund Revenues, Expenditures, Other
Financing Sources and Changes in Fund Balances for the Board⁽¹⁾**
(Amounts in Thousands)

	As of June 30,					
	Actual				Estimated	Budget
	1999	2000	2001	2002	2003 ⁽⁴⁾	2004 ⁽⁵⁾
Revenues:						
Property Taxes	\$1,314,362	\$1,352,374	\$1,379,010	\$1,429,307	\$1,495,382	\$1,524,700
Replacement Taxes	84,513	89,142	71,230	57,193	48,852	50,925
State Aid	1,190,289	1,247,174	1,275,707	1,336,586	1,302,735	1,318,943
Federal Aid	460,343	497,673	552,311	539,573	599,431	779,014
Investment Income	28,006	36,347	42,501	16,505	20,803	16,440
Other	71,113	65,515	78,107	66,917	76,840	77,000
Total Revenues	<u>\$3,148,626</u>	<u>\$3,288,225</u>	<u>\$3,398,866</u>	<u>\$3,446,081</u>	<u>\$3,544,043</u>	<u>\$3,767,022</u>
Expenditures						
Instruction	\$1,816,130	\$1,888,879	\$1,995,423	\$2,152,958	\$2,214,781	\$2,410,348
Pupil Services	271,876	301,714	303,071	311,628	321,005	381,129
Support Services	683,539	684,365	730,187	750,111	759,337	759,650
Food Services	154,581	161,614	166,365	160,063	170,238	179,318
Community Services	65,465	73,792	73,718	47,523	47,253	43,731
Capital Outlay	2,302	—	394	—	—	—
Teachers' Pension	65,045	65,045	65,045	65,045	65,045	65,045
Other	1,790	9,093	18,916	6,558	12,322	1,450
Total Expenditures	<u>\$3,060,728</u>	<u>\$3,184,502</u>	<u>\$3,353,119</u>	<u>\$3,493,886</u>	<u>\$3,589,981</u>	<u>\$3,840,671</u>
Revenues in Excess of (less than)						
Expenditures	\$ 87,898	\$ 103,723	\$ 45,747	\$ (47,805)	\$ (45,938)	\$ (73,649)
Other Financing Sources	—	11,436	(46,797) ⁽²⁾	1,527	7,711	—
Change in Fund Balance Revenues and Other Financing Sources in Excess of (Less than) Expenditures)	\$ 87,898	\$ 115,159	\$ (1,050)	\$ (46,278)	\$ (38,227)	\$ (73,649)
Fund Balance, Beginning of Period	361,895	449,793	564,952	411,412	365,134	326,907
Impact of Adopting GASB No. 33 ⁽³⁾	—	—	(152,490)	—	—	—
Fund Balance, End of Period	<u>\$ 449,793</u>	<u>\$ 564,952</u>	<u>\$ 411,412</u>	<u>\$ 365,134</u>	<u>\$ 326,907</u>	<u>\$ 253,258</u>
Composition of Ending Fund Balance:						
Reserved for:						
Encumbrances	\$ 107,951	\$ 102,623	\$ 149,675	\$ 118,726	\$ 78,880	\$ 78,880
Specific Purposes	53,587	69,272	60,218	36,525	45,820	20,820
Total Reserved Fund Balance	<u>\$ 161,538</u>	<u>\$ 171,895</u>	<u>\$ 209,892</u>	<u>\$ 155,251</u>	<u>\$ 124,700</u>	<u>\$ 99,700</u>
Unreserved:						
Designated to Provide Operating Capital	\$ 231,300	\$ 295,900	\$ —	\$ 201,500	\$ 202,207	\$ 153,528
Undesignated	56,955	97,157	201,520	8,383	—	—
Total Unreserved	<u>\$ 288,255</u>	<u>\$ 393,057</u>	<u>\$ 201,520</u>	<u>\$ 209,883</u>	<u>\$ 202,207</u>	<u>\$ 153,528</u>
Total Fund Balance	<u>\$ 449,793</u>	<u>\$ 564,952</u>	<u>\$ 411,412</u>	<u>\$ 365,134</u>	<u>\$ 326,907</u>	<u>\$ 253,228</u>

⁽¹⁾ The Board reports its financial activities through the use of fund accounting and follows the modified accrual basis of accounting for its Governmental Funds. See "APPENDIX A— Audited Financial Statements For Fiscal Year 2002— Note (2)."

⁽²⁾ Net Operating Transfer in fiscal year 2001 included \$48.8 million transferred to the Debt Service Funds to fund future debt service payments other than for the Bonds.

⁽³⁾ GASB No. 33 established new accounting rules which affect the timing of recognition of certain revenues. The impact of adoption resulted in a one-time restatement of opening fund balance and a deferral of revenue.

⁽⁴⁾ The Board expects to approve its audited financial statements for the fiscal year ended June 30, 2003, on or around December 17, 2003. See "FINANCIAL STATEMENTS."

⁽⁵⁾ Revenues and expenditures are in accordance with the Fiscal Year 2004 Budget. The approved Fiscal Year 2004 Budget re-appropriated \$25.0 million of ending fiscal year 2003 fund balance as reserved for specific purposes. The amounts shown in the table have been adjusted to reflect the estimated fiscal year end amount reserved for such purposes of \$20.8 million.

Outstanding Debt Obligations

Long-Term Debt Obligations. In addition to the Prior Alternate Bonds and the Bonds, the Board's outstanding long-term debt consists of approximately \$496 million aggregate principal amount of leases with The Public Building Commission of Chicago (the "PBC Leases"). The lease rentals due under the PBC Leases are supported by separate unlimited property tax levies of the Board. For additional information on the Public Building Commission, see "OTHER LOCAL GOVERNMENT UNITS—Other Public Bodies—The Public Building Commission of Chicago." To provide for payment of the lease rentals under the PBC Leases, the Board has established lease payment debt service fund accounts with a lease payment trustee. Under the School Code and resolutions of the Board establishing those trust accounts, the Board has levied a separate tax unlimited as to rate or amount on real property within the School District to pay the lease rentals under the PBC Leases. Tax receipts of the Board attributable to the Board's PBC Leases are required to be paid by the County Collector directly to the lease payment trustee and deposited in a fund account to be used for the payment of the applicable lease rentals under the PBC Leases when due. Investment income on deposits in the fund accounts established to make lease rentals under the PBC Leases is paid to the Board to the extent not needed to meet the lease obligations for which the particular fund account is established.

Board's Debt Service Schedule

Calendar Year	Prior Alternate Bonds			The Bonds ⁽⁵⁾	Total Annual Debt Service
	Bonds ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	Commission Obligations ⁽¹⁾	PBC Leases ⁽²⁾		
2003	\$ 131,184,379	\$ 81,777,388	\$ 51,834,588	—	\$ 264,796,355
2004	140,919,698	82,272,438	51,863,450	\$ 7,816,248	282,871,834
2005	142,691,673	116,578,250	51,572,450	14,590,469	325,432,842
2006	139,691,821	—	51,990,050	14,586,383	206,268,254
2007	144,458,901	—	52,037,000	14,596,518	211,092,419
2008	146,714,926	—	52,096,838	14,598,673	213,410,437
2009	221,778,751	—	52,103,825	14,608,198	288,490,774
2010	225,289,319	—	52,163,338	14,631,570	292,084,227
2011	238,346,142	—	52,232,025	14,616,639	305,194,806
2012	218,761,217	—	52,318,625	14,614,041	285,693,883
2013	240,586,692	—	52,359,513	14,621,841	307,568,046
2014	227,819,627	—	52,430,550	14,662,532	294,912,709
2015	237,415,157	—	52,467,613	15,172,702	305,055,472
2016	228,486,668	—	52,519,550	15,198,493	296,204,711
2017	225,173,798	—	52,600,125	15,210,851	292,984,774
2018	228,745,596	—	52,664,600	14,736,288	296,146,484
2019	252,538,649	—	30,635,500	14,756,801	297,930,950
2020	283,209,232	—	—	14,807,139	298,016,371
2021	283,333,635	—	—	14,808,629	298,142,264
2022	283,316,609	—	—	14,863,507	298,180,116
2023	278,417,117	—	—	14,682,427	293,099,544
2024	278,383,774	—	—	14,680,282	293,064,056
2025	278,405,598	—	—	14,734,832	293,140,430
2026	278,378,454	—	—	14,786,174	293,164,628
2027	278,370,422	—	—	14,820,311	293,190,733
2028	278,386,014	—	—	14,846,850	293,232,864
2029	278,333,711	—	—	14,886,007	293,219,718
2030	278,323,080	—	—	14,915,653	293,238,733
2031	278,326,588	—	—	14,926,182	293,252,770
2032	39,419,987	—	—	14,971,098	54,391,085
2033	—	—	—	15,035,088	15,035,088
2034	—	—	—	15,080,604	15,080,604
	<u>\$6,785,207,235</u>	<u>\$280,628,076</u>	<u>\$865,889,640</u>	<u>\$451,863,031</u>	<u>\$8,383,587,982</u>

- (1) At June 30, 2003, the Board held on deposit \$326,268,402 for Prior Alternate Bond debt service, of which \$173,083,469 from state school construction grants is for the Commission Obligations from Calendar Year 2004—2005.
- (2) Debt service payments include principal and interest due to and including the following January 1.
- (3) Interest on \$303,000,000 of variable rate Bonds Series 2000B, C, D is calculated at an assumed rate of 6% per annum.
- (4) Interest on \$183,775,000 of auction rates Series 2003B bonds is calculated at the swap rate of 3.782% based on a 360-day year consisting of twelve 30-day months. In a 35-day Auction Rate Mode, there may be 11, 12 or 13 interest payment dates in a given year. In the event the payments resulting from the actual Auction Rate are higher than the actual payments received from the Swap Provider, the Board will be required to make payments equal to the amount of any resulting shortfall.
- (5) Interest on approximately \$72,575,000 of auction rate Series 2003D-1 Bonds and Series 2003D-2 Bonds is calculated at an assumed rate of 5% per annum. Interest on \$185,350,000 of auction rate Series 2003D-2 Bonds, Series 2003D-3 Bonds and Series 2003D-4 Bonds is calculated at the swap rate of 3.771% based on a 360 day year consisting of twelve 30-day months. In a 35-day Auction Rate Mode, there may be 11, 12 or 13 interest payment dates in a given year. In the event the payments resulting from the actual Auction Rate are higher than the actual payments received from the Swap Provider, the Board will be required to make payments equal to the amount of any resulting shortfall. The amount in 2004 includes interest paid from the date of issuance of the Bonds.

Board's Overlapping Debt Schedule
As of December 11, 2003
(Dollars in Thousands)

	<u>Amount</u>
Direct Debt	
The Bonds	\$ 257,925
Total Prior Bonds	2,979,743
Commission Obligations (principal component)	183,100
PBC Leases (principal component)	<u>496,444</u>
Total Direct Debt	<u>\$3,917,212</u>

	<u>Amount</u>	<u>Percent</u> <u>Applicable</u>	<u>Amount</u> <u>Applicable</u>
Overlapping Debt ⁽¹⁾			
City	\$4,835,782	100.00%	\$ 4,835,782
School Finance Authority	391,410	100.00	391,410
Community College District	118,545	100.00	118,545
Chicago Park District ⁽²⁾	528,021	100.00	528,021
Water Reclamation District	1,353,177	45.15	610,959
Cook County	2,552,390	44.19	1,127,900
Forest Preserve District	37,640	44.19	<u>16,633</u>
Total Overlapping Debt			<u>\$ 7,629,251</u>
Total Direct and Overlapping Debt			<u>\$ 11,546,463</u>

Selected Debt Statistics

Population (2000)	2,896,016 ⁽⁴⁾
Equalized Assessed Valuation (2002) ⁽³⁾	\$ 45,330,892 ⁽⁵⁾
Estimated Fair Market Value (2002)	\$189,362,475 ⁽⁶⁾

	<u>Per Capita⁽⁷⁾</u>	<u>EAV</u>	<u>FMV</u>
Direct Debt	\$1,352.62	8.64%	2.069%
Total Direct and Overlapping Debt	\$3,987.02	25.47%	6.098%

- (1) Excludes outstanding tax anticipation notes and warrants; includes the principal amount of PBC Bonds secured by leases with the following units of government:
 Community College District \$118,545,000
 Chicago Park District \$ 28,295,000
- (2) Includes \$379,405,000 of outstanding general obligation bonds issued as "alternate bonds" under the Debt Reform Act for which the alternate revenue source is personal property replacement tax revenues and parking revenues.
- (3) Cook County only.
- (4) Source: United States Census Bureau.
- (5) Source: Cook County Clerk's Office. Total Equalized Assessed Value is net of exemptions and includes assessment of pollution control facilities.
- (6) Source: The Civic Federation.
- (7) Per Capita amounts are not expressed as dollars in thousands.

Equalized Assessed Valuation and Statutory Debt Margin of the Board
(Dollars in Thousands)

	As of June 30,				
	1998	1999	2000	2001	2002
Equalized Assessed Valuation ⁽¹⁾	<u>\$33,357,600</u>	<u>\$33,947,364</u>	<u>\$35,361,964</u>	<u>\$40,487,129</u>	<u>\$41,988,859</u>
Statutory Debt Limit, 13.8% of					
Equalized assessed valuation	<u>\$ 4,603,349</u>	<u>\$ 4,684,736</u>	<u>\$ 4,879,951</u>	<u>\$ 5,587,224</u>	<u>\$ 5,794,463</u>
Principal amount of bonds outstanding ⁽²⁾	-0-	-0-	-0-	-0-	-0-
Principal amount of certificates of participation	23,500	12,000	-0-	-0-	-0-
Aggregate future rentals on leases with Public Building Commission ...	1,116,489	1,065,144	1,013,799	962,483	911,166
Less – Cash and investments on hand applicable to reduction of above debt	<u>(50,347)</u>	<u>(49,942)</u>	<u>(37,921)</u>	<u>(38,379)</u>	<u>(37,965)</u>
Net funded debt	<u>\$ 1,089,642</u>	<u>\$ 1,027,202</u>	<u>\$ 975,878</u>	<u>\$ 924,104</u>	<u>\$ 873,201</u>
Unfunded Debt:					
Contracts, leases, purchase orders and outstanding judgments	108,719	138,372	136,682	185,554	146,367
Asbestos abatement loans	<u>18,399</u>	<u>16,919</u>	<u>15,438</u>	<u>13,253</u>	<u>11,833</u>
Net unfunded debt	127,118	155,291	152,120	198,807	158,200
Total debt	<u>\$ 1,216,760</u>	<u>\$ 1,182,493</u>	<u>\$ 1,127,998</u>	<u>\$ 1,122,911</u>	<u>\$ 1,031,401</u>
Statutory debt margin ⁽²⁾	<u>\$ 3,386,589</u>	<u>\$ 3,502,243</u>	<u>\$ 3,751,953</u>	<u>\$ 4,464,313</u>	<u>\$ 4,763,062</u>

- (1) Represents Equalized Assessed Valuation at the end of the preceding tax levy year. For example, the Equalized Assessed Valuation shown in the table as of June 30, 2002 is for the tax levy year 2001.
- (2) Pursuant to Section 15 of the Debt Reform Act, this table does not reflect the Prior Alternate Bonds, which do not count against the debt limit unless the tax levy supporting them is extended for collection.

Employee Pension Obligations

Funding of Pension Obligations. Pension benefits for eligible teachers and administrators of the Board are provided under a defined benefit plan administered by the Public School Teachers' Pension and Retirement Fund of Chicago, a separate legal entity (the "Pension Fund"). See APPENDIX-A—"FISCAL YEAR 2002 AUDITED FINANCIAL STATEMENTS—Note (11)." The 1995 Amendatory Act provided that by fiscal year 1999 the Pension Fund would be funded using the same actuarial funding method as the Illinois Teachers' Retirement Fund. Applicable provisions of the Illinois Pension Code provide that this method will cause the ratio of the actuarially determined value of the assets of the Pension Fund to its actuarially determined accrued liabilities (or "Funded Ratio") to equal 90% by fiscal year 2045. As of June 30, 2002, the end of the last fiscal year of the Pension Fund for which audited financial information is available, the Funded Ratio for the Pension Fund, based on a four year "smoothed" (effectively, an average) market value method of valuing assets, was 96.5% and based on current market value was 84.7%. The Fund has had a significant decrease in its investment portfolio due to declining market conditions as a result of a softening economy. During the period from July 1, 2002 through September 30, 2002 the fair value of the Fund's investments decreased approximately \$907.2 million or 9.6%, to \$8,527.4 million.

The 1995 Amendatory Act and various additional amendments made to the School Code in 1996, 1997 and 1998: (i) eliminated the Board's obligation to make any local employer pension contribution unless the Funded Ratio of the Pension Fund would otherwise fall below 90%; and (ii) made additional changes to the Board's obligation to fund pension benefits. Based on the current Funded Ratio for the Pension Fund, the Board is not required to provide any contributions to the Pension Fund from local

resources in its fiscal year 2003 budget. Contributions to the Pension Fund that are funded by state categorical revenues for teacher pension and by federal categorical programs will continue as before.

Pension Funding Litigation. The Board is involved in litigation with respect to its calculations of certain Pension Fund obligations. See “LITIGATION AND ADMINISTRATIVE MATTERS—Pension Funding Litigation.”

Debt Management Policy

To help ensure the Board’s creditworthiness, the Board adopted a Debt Management Policy (the “Debt Policy”) on October 23, 1996. The purpose of the Debt Policy is to provide a functional tool for debt management and capital planning and to enhance the Board’s ability to manage its debt in a conservative and prudent manner. In issuing the Bonds and any future debt, the Board will consider a number of factors, including the duration of the debt in relation to the economic life of the improvement or asset that the issue is financing, negotiated and competitive methods of sale, conditions in both domestic and international markets, credit enhancement agreements, the potential impact of debt service on the operating budget, statutory debt limitations, and credit implications. The Board also believes it should avoid financing general operating costs from debt having maturities greater than one year. A copy of the Debt Policy is available from the Board upon request to the Treasurer of the Board at (773) 553-2790. The Debt Policy may be subsequently amended or modified by the Board, without notice to or consent of the owners of the Bonds.

Prior to entering into a derivative transaction associated with the Board’s Series 2003B Bonds issued in February 2003, guidelines for the use of derivative instruments in managing the Board’s debt portfolio were prepared and distributed to the Board. The guidelines address compliance with government regulations; appropriate purposes for entering into derivative transactions; the impact of potential risks on the Board’s future debt service, budgetary obligations, and long-term credit ratings; accounting treatment; bid solicitation methodology; and other long-term considerations related to the Board’s debt portfolio. The board is in the process of amending its Debt Management Policy, including the use of derivative instruments.

Investment Policy

The Board has adopted an Investment Policy (the “Investment Policy”). The objectives of the Investment Policy are to invest public funds in a manner which is consistent with all state and local statutes governing the investment of public funds and which will provide for the safety of principal, diversification and maximization of the rate of return. The Investment Policy specifically prohibits any purchase of financial futures, any leveraged investment lending securities and any collateralized mortgage obligations. The Investment Policy may be subsequently amended or modified by the Board, without notice to or consent of the Owners of the Bonds subject, in all respects, to the provisions of the Public Funds Investment Act of the State of Illinois, as amended. A copy of the Investment Policy is available from the Board upon request to the Treasurer of the Board at (773) 553-2790. All investments of the moneys on deposit in the Funds and Accounts established under the Indenture are subject to the provisions of the Investment Policy as in effect.

OTHER LOCAL GOVERNMENTAL UNITS

Overlapping Entities

There are eight major units of local government located in whole or in part within the boundaries of the school district governed by the Board, each of which (i) is separately incorporated under the laws

of the State, (ii) has an independent tax levy, (iii) derives its power and authority under the laws of the State, (iv) maintains its own financial records and accounts and (v) is authorized to issue debt obligations. These units are: the City; the Board; the Chicago School Finance Authority; the Chicago Park District; Community College District Number 508; Cook County; the Forest Preserve District of Cook County; and the Metropolitan Water Reclamation District of Greater Chicago. Each of the foregoing governmental units levies taxes upon property located in the City, and, in some cases, in other parts of Cook County as well. For additional information about the Board, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO.” Information about these other units of local government is set forth below.

Major Units of Government

The City of Chicago is a home rule unit of government under the Illinois Constitution, and was incorporated in 1837. The City is governed by the Mayor, who is elected at-large for a four-year term, and a City Council (the “City Council”). The City Council consists of 50 aldermen each representing one of the City’s 50 wards, elected for four-year terms.

The Chicago Park District (the “Park District”) has boundaries coterminous with the City and is responsible for the maintenance and operation of parks, boulevards, marinas and certain other public property within the City. The Park District is governed by a seven-member board, appointed by the Mayor with the approval of the City Council.

Community College District Number 508 (the “Community College District”) is responsible for maintaining and operating a system of community colleges within the City. The governing body is a board of seven trustees appointed by the Mayor with the approval of the City Council.

The County of Cook (the “County”) is a home rule unit of government under the Illinois Constitution, and includes virtually all of the City, plus numerous surrounding suburbs and unincorporated areas. The County is governed by a board of 17 Commissioners, each elected for four-year terms from one of 17 districts. The President of the County Board of Commissioners is elected by the voters of the entire County. The voters of the entire County also elect a number of other County Officials, including the County Sheriff, the County Assessor, the County Clerk, the State’s Attorney and the County Treasurer. The County is primarily responsible for the operation of the criminal justice system, the provision of health care services and numerous functions relating to property tax administration.

The Forest Preserve District of Cook County (the “Forest Preserve District”) has boundaries coterminous with the County and is responsible for establishing, maintaining and operating forest preserves within the County. The governing body is composed of the members of the County Board of Commissioners, chaired by the President of the County Board of Commissioners.

The Metropolitan Water Reclamation District of Greater Chicago (the “Water Reclamation District”), formerly known as the Metropolitan Sanitary District of Greater Chicago, includes virtually all of the City and most of the County. The Water Reclamation District constructs, maintains and operates sewage treatment plants and certain sanitary sewers. In addition, the Water Reclamation District constructs and maintains drainage outlets. The Water Reclamation District is governed by a nine-member board elected at-large by the voters of the Water Reclamation District.

Interrelationships of These Bodies

The overlapping governmental taxing bodies described above and the Chicago School Finance Authority, described below, share in varying degrees a common property tax base with the Board. See “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Direct And Overlapping Debt.” However

each such public body is a separate and distinct governmental unit. The financial condition of any such body does not imply the same condition for the Board.

Other Public Bodies

Other governmental bodies in the Board's geographical boundaries are described below. These governmental bodies are authorized to issue debt obligations, but are not authorized to levy real property taxes.

The Public Building Commission of Chicago (the "PBC") is a municipal corporation authorized to acquire, construct and improve public buildings and facilities for use by one or more of the local governmental units. The PBC issues bonds to finance its various projects and then leases its facilities to certain governmental units. At present, the Board leases substantially all school buildings and facilities from the PBC. Several other of the major governmental units described above also lease facilities from the PBC. See "BOARD OF EDUCATION OF THE CITY OF CHICAGO—Direct And Overlapping Debt."

The Mayor, also one of the members of the PBC, appoints six of the 10 additional members of the PBC. Currently, a member of the School Board is one of these members. The presiding officers of the Park District and the Water Reclamation District each appoint one member while the County appoints two members. The PBC is not authorized to levy real property or other taxes, but the public bodies which lease facilities from the PBC, including the Board, levy real property taxes to make the required lease rental payments.

The Chicago Transit Authority (the "CTA") is a municipal corporation empowered to acquire, construct, own, operate and maintain a transportation system in the City and portions of the County. The CTA is governed by a seven-member board. Four members are appointed by the Mayor with the approval of the City Council, and three members are appointed by the Governor with the approval of the State Senate. The CTA board elects a Chairman from its members who serves for a term of three years.

The Regional Transportation Authority (the "RTA") is a municipal corporation authorized to provide planning, funding, coordination and fiscal oversight of three separately governed operating entities which provide public mass transportation services in a six-county area of northeastern Illinois, including Cook County. These include the CTA, METRA, the suburban rail division, and PACE, the suburban bus division. The RTA is governed by a 13-member board, consisting of City and suburban members appointed by elected officials in the six-county RTA region. The RTA is primarily funded by taxes imposed by the RTA on retail sales in the six-county area, and an amount from the State equal to one-fourth of the sales taxes collected in the region by the State. The RTA is also authorized to impose, but does not presently impose, taxes on automobile rentals, motor fuel and off-street parking facilities. By law, motor fuel and off-street parking taxes may not be imposed concurrently with sales taxes.

The Metropolitan Pier and Exposition Authority (the "MPEA") is a municipal corporation which owns and operates the McCormick Place convention and exposition facilities and Navy Pier. MPEA has previously issued revenue bonds to finance its projects. MPEA is governed by a 13-member board, six of whom are appointed by the Governor, with the approval of the State Senate, and six of whom are appointed by the Mayor. The Mayor also appoints, with the approval of the Governor, one additional member who also serves as Chairman of MPEA. The Chief Executive Officer is appointed by the Governor, with the approval of the Mayor. MPEA receives revenue from the operation of its facilities and from the imposition of sales and other consumption-related taxes.

Various authorities have been created under Illinois law to facilitate the financing of educational facilities, health facilities, highways, housing, industrial development, sports facilities, port facilities and other activities. These authorities are not authorized to levy real property taxes.

Chicago School Finance Authority

The Chicago School Finance Authority has outstanding debt issued for the benefit of the School District and is discussed below.

Establishment. In 1979 and early 1980, the Board experienced severe financial difficulties. In January 1980, as part of a plan to address these financial difficulties, the Illinois General Assembly established the Chicago School Finance Authority (the “Authority”). The Authority is governed by a five-member board of directors: two directors are appointed by the Mayor with the approval of the Governor; two directors are appointed by the Governor with the approval of the Mayor; the Chairman is appointed jointly by the Governor and the Mayor. The Authority will remain in existence until one year after all bonds and notes issued by it have been discharged. The final payment of principal and interest on the outstanding bonds issued by the Authority is scheduled to occur in calendar year 2009.

Financial Oversight and Control Powers. Prior to the adoption of the 1995 Amendatory Act, the Authority was authorized to exercise certain financial oversight and control powers with respect to the Board. Effective with the passage of the 1995 Amendatory Act, the Authority’s financial oversight and control powers were suspended until July 1, 1999. The suspension of these oversight and control powers has been extended until December 31, 2010.

Debt Obligations. Since 1980, the Authority has issued \$1,236,450,000 of its general obligation bonds to provide the Board with moneys for operating purposes, school rehabilitation and school construction purposes, working cash purposes and to refinance short-term debt obligations and to refund outstanding bonds of the Authority. See APPENDIX-A— “FISCAL YEAR 2002 AUDITED FINANCIAL STATEMENTS—Note (12)”, for a more complete description of the uses of the proceeds of the various series of bonds issued by the Authority. As of the date of this Official Statement, \$391,410,000 of the Authority’s bonds are outstanding, net of bonds defeased. As of the date of this Official Statement, the Authority has no authority to issue bonds other than to refund outstanding bonds. The Authority’s bonds are general obligations of the Authority, payable from a separate real estate tax levied on all real property in the School District without limit as to rate or amount. The Authority’s bonds are not a direct or contingent obligation of the Board. The Authority’s levy is a separate levy in addition to all taxes which the Board or the City are authorized to levy. For additional information, see “BOARD OF EDUCATION OF THE CITY OF CHICAGO—Direct and Overlapping Debt.”

THE REAL PROPERTY TAX SYSTEM

Real Property Assessment, Tax Levy and Collection Procedures

General. The following is a general summary of the real property assessment, taxing, and collection procedures applicable to the School District and counties in which it is located. As described under “SECURITY FOR THE BONDS—Pledged Taxes,” the Pledged Taxes, to the extent they are levied and collected, will be derived from the proceeds of ad valorem taxes levied by the Board on all taxable property within the School District.

Substantially all (approximately 99.98%) of the “Equalized Assessed Valuation” (described below) of taxable property in the School District is located in Cook County (the “County”). The remainder is located in DuPage County. Accordingly, unless otherwise indicated, the information set

forth under this caption and elsewhere in this Official Statement with respect to taxable property of the School District does not reflect the portion situated in DuPage County. The Illinois laws relating to real property are contained in the Illinois Property Tax Code, 35ILCS 200, *et seq.*, as amended (the “Property Tax Code”).

Assessment. The Cook County Assessor (the “Assessor”) is responsible for the assessment of all taxable real property within the County, except for certain railroad property and pollution control equipment assessed directly by the State. One-third of the real property in the County is reassessed each year on a repeating triennial schedule established by the Assessor. The City was reassessed in tax year 2003 the suburbs in the northern and northwestern portions of the County will be reassessed in tax year 2004. The suburbs in the western and southern portions of the County will be reassessed in tax year 2005.

Pursuant to the Cook County Classification Ordinance, real property in the County is separated into nine classifications for assessment purposes. After the Assessor establishes the fair cash value of a parcel of land, that value is multiplied by one of the classification percentages to arrive at the assessed valuation (the “Assessed Valuation”) for the parcel. The current classification percentages range from 16 percent for certain residential, commercial and industrial properties to 36 percent and 38 percent, respectively, for other industrial and commercial property.

The Assessor has established procedures enabling taxpayers to contest their tentative Assessed Valuations. Once the Assessor certifies final Assessed Valuations, a taxpayer can seek review of its assessment by filing a complaint with the Cook County Board of Review (the “Board of Review”). The Board of Review consists of three commissioners, each elected by an election district in Cook County. The Board of Review is empowered to review and adjust Assessed Valuations set by the Assessor.

Owners of property are able to appeal decisions of the Board of Review to the Illinois Property Tax Appeal Board (the “PTAB”), a statewide administrative body. The PTAB has the power to determine the Assessed Valuation of real property based on equity and the weight of the evidence. Depending on the amount of the proposed change in Assessed Valuation, taxpayers may appeal decisions of the PTAB to either the Circuit Court of Cook County or the Illinois Appellate Court under the Illinois Administrative Review Law.

In March 2000 and August 2001, the PTAB rendered two series of decisions in which it granted reduced assessed valuations to the owners of certain real property by employing lower levels of assessment. In the March 2000 decisions, the PTAB elected to utilize the median levels of assessment derived from the Illinois Department of Revenue’s sales-ratio studies (the “Sales-Ratio Studies”) as the mechanism for determining correct assessment levels, instead of those set forth in the Cook County Real Property Assessment Classification Ordinance (the “Classification Ordinance”). Use of the Sales-Ratio Studies resulted in a lower assessment level than required by the Classification Ordinance. In its August 2001 decisions, after examining the Sales Ratio Studies, the PTAB held that the Cook County Assessor’s assessment practices violated a provision of the State Constitution, which limits the level of assessment of the highest class of property, in a county that classifies property, to two and one-half times the level of assessment of the lowest class of property in that county. As a result, the PTAB established a maximum assessment level that is significantly below the assessment levels for commercial and industrial property currently set forth in the Classification Ordinance.

The Board of Review, through the Cook County State’s Attorney Office, appealed the March 2000 decision and August 2001 decision of the PTAB to the Illinois Appellate Court (the “Appellate Court”). On August 20, 2002, the Appellate Court issued an opinion affirming in part and reversing in part the March 2000 decisions concerning the PTAB’s use of the Sales-Ratio Studies. Shortly thereafter, the PTAB filed a petition for leave to appeal with the Illinois Supreme Court asking the Court to review

the Appellate Court's decision. On October 7, 2003, the Illinois Supreme Court denied the PTAB's petition for leave to appeal. The PTAB then filed a motion asking the Court to reconsider the denial of the petition for leave to appeal. On or about November 7, 2003, the Court denied the motion requesting reconsideration of the denial of the petition for leave to appeal. In November of 2002, the Appellate Court heard oral argument on the PTAB's August 2001 decisions concerning the two and one-half times level of assessment. The Appellate Court has not yet released its opinion in this appeal.

With the denial of the PTAB's petition for leave to appeal on the use of the Sales-Ratio studies in PTAB decisions, the PTAB may no longer automatically apply the Sales-Ratio studies in its decisions. As a practical matter, this will mandate the use of the Classification Ordinance in all PTAB decisions. The Appellate Court did not, however, foreclose a taxpayer from proving the validity of the Sales-Ratio studies and establishing a level of assessment for Cook County property types other than the levels of assessment indicated by the Classification Ordinance. The decision simply prohibits the PTAB from applying the Sales-Ratio studies on its own, without proof of the studies validity. Because the Appellate Court has not yet released its decision in the two and one-half times level of assessment appeal, this interpretation is subject to change.

As an alternative to seeking review of Assessed Valuations by the PTAB, taxpayers who have first exhausted their remedies before the Board of Review may file an objection in the Circuit Court of Cook County. In addition, in cases where the Assessor agrees that an assessment error has been made after tax bills have been issued, the Assessor can correct the Assessed Value, and thus reduce the amount of taxes due, by issuing a certificate of error.

All reviews of assessments, whether before the Board of Review, the PTAB or the courts are decided on a case-by-case basis.

Equalization. After the Assessed Valuation for each parcel of real estate in a county has been determined for a given year (including any revisions made by the Board of Review), the Illinois Department of Revenue reviews the assessments and determines an equalization factor (the "Equalization Factor"), commonly called the "multiplier," for each county. The purpose of equalization is to bring the aggregate assessed value of all real estate in each county, except certain farmland and undeveloped coal, to the statutory requirement of 33-1/3 percent of estimated fair cash value. Adjustments in Assessed Valuation made by the PTAB or the courts are not reflected in the Equalization Factor. The Assessed Valuation of each parcel of real estate in the County is multiplied by the County's Equalization Factor to determine the parcel's equalized assessed valuation (the "Equalized Assessed Valuation").

The Equalized Assessed Valuation for each parcel is the final property valuation used for determination of tax liability. The aggregate Equalized Assessed Valuation for all parcels in any taxing body's jurisdiction, after reduction for all applicable exemptions, plus the valuation of property assessed directly by the State, constitutes the total real estate tax base for the taxing body and is the figure used to calculate tax rates (the "Assessment Base"). The Equalization Factor for a given year is used in computing the taxes extended for collection in the following year. The Equalized Assessed Valuation used to determine any applicable tax limits is the one for the immediately preceding year and not the current year. See "Property Tax Extension Limitation Law; Issuance of Alternate Bonds" below. For a listing of the Equalization Factors for the ten years ended December 31, 2002, see "Property Tax Information—ASSESSED, EQUALIZED ASSESSED AND ESTIMATED VALUE OF ALL TAXABLE PROPERTY 1993-2002."

Exemptions. The annual general homestead exemption provides for the reduction of the Equalized Assessed Valuation of certain property owned and used exclusively for residential purposes by the amount of any increase over the 1977 Equalized Assessed Valuation, up to a maximum reduction of \$4,500. Additional exemptions exist for (i) senior citizens, with the Assessor authorized to reduce the

Equalized Assessed Valuation on a senior citizen's home by \$2,500, and (ii) disabled veterans, with the Assessor authorized annually to exempt up to \$58,000 of the Assessed Valuation of certain property owned and used exclusively by such veterans or their spouses for residential purposes. A homestead improvement exemption allows homeowners to exempt up to \$45,000 of the increase in the fair cash value of their residence due to certain home improvements to an existing structure without increasing the Assessed Valuation of their property for at least four years. For rehabilitation of certain historic property, the Equalized Assessed Valuation is limited for eight years to the value when the rehabilitation work began. The Senior Citizens Tax Freeze Homestead Exemption freezes property tax assessments for homeowners who are 65 and older and have annual incomes of \$40,000 or less. Certain property is also exempt from taxation on the basis of ownership and/or use.

Additionally, counties have been authorized to create special property tax exemptions in long-established residential areas or in areas of deteriorated, vacant or abandoned homes and properties. Under such an exemption, longtime, residential owner-occupants in eligible areas would be entitled to a deferral or exemption from that portion of property taxes resulting from an increase in market value because of refurbishment or renovation of other residences or construction of new residences in the area. On June 5, 2001, the County enacted the Longtime Homeowner Exemption Ordinance, which provides property tax relief from dramatic rises in property taxes directly or indirectly attributable to gentrification in the form of an exemption of certain homeowners who have resided in their homes for 10 consecutive years (or five consecutive years for homeowners who have received assistance in the acquisition of the property as part of a government or nonprofit housing program), and whose annual household income for the year of assessment does not exceed 115% of the Chicago Primary Metropolitan Statistical Area median income as defined by United States Department of Housing and Urban Development.

Tax Levy. There are over 800 units of local government (the "Units") located in whole or in part in the County that have taxing power. The major Units having taxing power over property within the County are the Board, the City, the Park District, the Authority, the Community College District, the Water Reclamation District, the County and the Forest Preserve District.

As part of the annual budgetary process of the Units, each year in which the determination is made to levy real estate taxes, proceedings are adopted by the governing body of each Unit. The tax levy proceedings impose the Units' respective real estate taxes in terms of a dollar amount. Each Unit certifies its real estate tax levy, as established by the proceedings, to the County Clerk's Office. The remaining administration and collection of the real estate taxes is statutorily assigned to the County Clerk and the County Treasurer, who is also the County Collector.

After the Units file their annual tax levies, the County Clerk computes the annual tax rate for each Unit by dividing the levy of each Unit by the Assessment Base of the respective Unit. If any tax rate thus calculated or any component of such a tax rate (such as a levy for a particular fund) exceeds any applicable statutory rate limit, the County Clerk disregards the excessive rate and applies the maximum rate permitted by law.

The County Clerk then computes the total tax rate applicable to each parcel of real property by aggregating the tax rates of all the Units having jurisdiction over the particular parcel. The County Clerk enters in the books prepared for the County Collector (the "Warrant Books") the tax (determined by multiplying that total tax rate by the Equalized Assessed Valuation of that parcel), along with the tax rates, the Assessed Valuation and the Equalized Assessed Valuation. The Warrant Books are the County Collector's authority for the collection of taxes and are used by the County Collector as the basis for issuing tax bills to all property owners.

Collection. Property taxes are collected by the County Collector, who remits to each Unit its share of the collections. Taxes levied in one year become payable during the following year in two

installments, the first always due on March 1 and the second due on the later of August 1 or 30 days after the mailing of the tax bills. The first installment is an estimated bill equal to one-half of the prior year's tax bill. The second installment is for the balance of the current year's tax bill, and is based on the current levy, assessed value and Equalization Factor and applicable tax rates, and reflects any changes from the prior year in those factors. Over the last 10 years, the second installment "penalty date" (that is, the date after which interest is due on unpaid amounts) has not been later than November 3. It is possible that delays in the assessment process or changes to the assessment appeal process described above will cause delays in the preparation and mailing of second installment tax bills in future years.

The County may provide for tax bills to be payable in four installments instead of two. The County has not determined to require payment of tax bills in four installments. During the periods of peak collections, tax receipts are forwarded to each Unit weekly.

At the end of each collection year, the County Collector presents the Warrant Books to the Circuit Court and applies for a judgment for all unpaid taxes. The court order resulting from the application for judgment provides for an annual sale of all unpaid taxes shown on the year's Warrant Books (the "Annual Tax Sale"). The Annual Tax Sale is a public sale, at which time successful tax buyers pay the unpaid taxes plus penalties. Unpaid taxes accrue penalties at the rate of 1.5 percent per month from their due date until the date of sale. Taxpayers can redeem their property by paying the amount paid at the sale, plus a maximum of 18 percent for each six-month period after the sale. If no redemption is made within the applicable redemption period (ranging from six months to two and one-half years depending on the type and occupancy of the property) and the tax buyer files a petition in Circuit Court, notifying the necessary parties in accordance with applicable law, the tax buyer receives a deed to the property. In addition, there are miscellaneous statutory provisions for foreclosure of tax liens.

If there is no sale of the tax lien on a parcel of property at the Annual Tax Sale, the taxes are forfeited to the State and are eligible to be purchased at any time thereafter at an amount equal to all delinquent taxes interest and certain other costs to the date of purchase. Redemption periods and procedures are the same as applicable to the Annual Tax Sale.

A scavenger sale (the "Scavenger Sale"), like the Annual Tax Sale, is a sale of unpaid taxes. A Scavenger Sale is scheduled to be held every two years on all property in which taxes are delinquent for two or more years. The sale price of the unpaid taxes is the amount bid at the Scavenger Sale, which may be less than the amount of the delinquent taxes. Redemption periods vary from six months to two and one-half years depending upon the type and occupancy of the property.

Property Tax Extension Limitation Law; Issuance of Alternate Bonds

The Illinois Property Tax Extension Limitation Law (the "Limitation Law"), previously applicable only to non-home rule taxing districts located in DuPage, Kane, Lake, McHenry and Will Counties, was extended in 1995 to non-home rule taxing districts in Cook County, including the Board. The effects of the Limitation Law are to limit or retard the growth in the amount of property taxes that can be extended for a non-home rule taxing body and to impose direct referendum requirements upon the issuance of certain types of general obligation bonds by such non-home rule taxing bodies.

The Limitation Law specifically limits the annual growth in property tax extensions for the Board to the lesser of 5% or the percentage increase in the Consumer Price Index for All Urban Consumers during the calendar year preceding the relevant levy year. Generally, extensions can be increased beyond this limitation only due to increases in the equalized assessed value attributable to new construction and referendum approval of tax or limitation rate increases.

The Limitation Law requires the Cook County Clerk, in extending taxes for taxing districts in Cook County, including the Board, to use the Equalized Assessed Valuation of all property within the taxing district for the levy year prior to the levy year for which taxes are then being extended.

The Limitation Law (i) authorizes the issuance of “limited bonds” payable from non-home rule taxing districts’ “debt service extension base”; and (ii) excludes certain types of general obligation bonds, known as “alternate bonds” issued pursuant to Section 15 of the Debt Reform Act, from the direct referendum requirements of the Limitation Law. Pursuant to the provisions of this amendatory legislation and the Debt Reform Act, the Bonds are being issued as alternate bonds. For additional information, see “INTRODUCTION—Prior Alternate Bonds.” The extension and collection of the Pledged Taxes, to the extent received, for the payment of debt service on the Bonds are not limited or restricted in any way by the provisions of the Limitation Law.

Illinois Truth in Taxation Law. The Illinois Truth in Taxation Law imposes procedural limitations on a Unit real estate taxing powers and requires that notice in the prescribed form must be published if the aggregate annual levy is estimated to exceed 105% of the levy of the preceding year, exclusive of levies for debt service, election cost and payments due under public building commission leases. A public hearing must also be held, which may not be in conjunction with the budget hearing of the Unit on the adoption of the Unit’s annual levy. No amount in excess of 105% of the preceding year’s levy may be used as the basis for issuing tax bills to property owners unless the levy is accompanied by a certification of compliance with the foregoing procedures. This law does not impose any limitations on the rate or the amount of the levy to pay principal of and interest on the Unit’s general obligation bonds and notes.

Bond Issue Notification Act

The Bond Issue Notification Act of the State of Illinois (the “Bond Issue Notification Act”) requires a public hearing to be held by any governmental unit proposing to sell non-referendum general obligation bonds or limited bonds subject to backdoor referendum. The public hearing is intended to require the governing body approving the bond issue to explain the reasons for the proposed issuance and allow persons desiring to be heard an opportunity to present written or oral testimony. On July 24, 2002, pursuant to properly published notice, the Board held the hearing required by the Bond Issue Notification Act with respect to all bonds issued under the 2002 Authorization, including the Bonds.

Property Tax Information

The tables on the following pages provide statistical data regarding the property tax base of the Board and the City; the tax rates, tax levies and tax collections for the Board; and the tax levies and property tax supported debt for overlapping units of government in Cook County.

ASSESSED, EQUALIZED ASSESSED AND ESTIMATED VALUE OF ALL TAXABLE PROPERTY 1993-2002
(Dollars in Thousands)

Tax Year Levy	Assessed Values ⁽¹⁾					State Equalization Factor ⁽²⁾	Total Equalized Assessed Value ⁽³⁾	Total Estimated Fair Cash Value ⁽⁴⁾	Total Equalized Assessed Value as a Percentage of Total Estimated Fair Cash Value
	Class 2 ⁽⁵⁾	Class 3 ⁽⁶⁾	Class 5 ⁽⁷⁾	Other ⁽⁸⁾	Total				Total Estimated Fair Cash Value
2002	\$9,221,622	\$1,865,646	\$8,878,142	\$349,371	\$20,314,781	2.4689	\$45,330,892	\$189,362,475	23.94%
2001	8,973,796	1,923,257	8,757,366	354,036	20,008,455	2.3098	41,981,912	164,572,708	25.51
2000	8,758,682	1,966,921	8,807,444	342,942	19,875,989	2.2235	40,480,077	165,520,130	24.46
1999	6,777,400	2,021,411	7,910,838	282,255	16,991,904	2.2505	35,354,802	124,544,158	28.39
1998	6,646,198	2,047,577	7,848,335	267,006	16,809,116	2.1799	33,940,146	112,606,894	30.14
1997	6,554,717	2,077,044	7,809,486	262,032	16,703,279	2.1489	33,349,557	106,282,207	31.38
1996	5,843,068	1,930,178	7,338,644	255,507	15,367,397	2.1517	30,765,001	100,460,113	30.62
1995	5,769,559	1,979,007	7,374,840	241,356	15,364,762	2.1243	30,381,480	97,291,356	31.23
1994	5,701,638	2,016,367	7,357,659	244,451	15,320,115	2.1135	30,090,355	94,181,737	31.95
1993	5,095,776	1,878,201	7,135,798	250,349	14,360,124	2.1407	26,661,954	94,219,759	28.30

(1) Source: Cook County Assessor's Office.

(2) Source: Illinois Department of Revenue.

(3) Source: Cook County Clerk's Office. Calculations are net of exemptions and include assessment of pollution control facilities. Excludes DuPage County Valuation.

(4) Source: The Civic Federation. Excludes railroad property.

(5) Residential, six units and under.

(6) Residential, seven units and over and mixed-use.

(7) Industrial/Commercial.

(8) Vacant, not-for-profit and industrial/commercial incentive classes.

Board's Property Tax Extensions and Collections
(Dollars in Thousands)

Levy Year⁽²⁾	Extension	First Year Collections		Cumulative Collections⁽¹⁾	
		Amount	Percent	Amount	Percent
2002	\$1,614,473	\$1,534,497	95.0%	\$1,534,497	95.0%
2001	1,571,962	1,519,630	96.6	1,563,941	99.5
2000	1,503,488	1,446,847	96.2	1,486,624	98.9
1999	1,451,206	1,408,124	97.0	1,430,966	98.6
1998	1,416,346	1,317,872	93.0	1,387,928	98.0
1997	1,362,211	1,304,701	95.8	1,333,689	97.9
1996	1,331,437	1,293,278	97.1	1,287,758	96.7
1995	1,291,784	1,240,528	96.0	1,243,870	96.3
1994	1,253,800	1,189,147	94.8	1,201,832	95.9
1993	1,239,344	1,193,613	96.3	1,194,358	96.4

(1) Reflects collections through November 17, 2003.

(2) Year of extension is the year after the year of levy.

Source: Board of Education of the City of Chicago

Real Property Tax Rates⁽¹⁾
(per \$100 equalized assessed valuation)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
<u>Tax Rates by Board Fund:⁽²⁾</u>										
Educational.....	\$2.444	\$2.262	\$3.196	\$3.202	\$2.998	\$3.059	\$3.000	\$2.756	\$2.712	\$2.670
Special Education.....	0.039	0.038	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
School District Medicare.....	0.028	0.030	0.034	0.023	0.022	0.044	0.048	0.047	0.031	0.017
Agricultural Science.....	0.003	0.008	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Building.....	0.439	0.429	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Playground and Recreational.....	0.078	0.076	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Textbook	0.107	0.105	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Workers' and Unemployment										
Compensation Tort Immunity.....	0.207	0.229	0.254	0.222	0.246	0.192	0.206	0.141	0.191	0.150
Teachers' Pension	0.254	0.248	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
PBC Operation and Maintenance	0.538	0.565	0.594	0.709	0.719	0.722	0.701	0.640	0.685	0.609
Bond Redemption & Interest.....	0.013	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
PBC Lease Rentals	<u>0.173</u>	<u>0.177</u>	<u>0.173</u>	<u>0.171</u>	<u>0.099</u>	<u>0.155</u>	<u>0.149</u>	<u>0.130</u>	<u>0.125</u>	<u>0.116</u>
Board Subtotal	<u>\$4.323</u>	<u>\$4.167</u>	<u>\$4.251</u>	<u>\$4.327</u>	<u>\$4.084</u>	<u>\$4.172</u>	<u>\$4.104</u>	<u>\$3.714</u>	<u>\$3.744</u>	<u>\$3.562</u>
<u>Other Major Government Units:</u>										
City of Chicago	2.228	2.158	2.131	2.182	2.024	1.998	1.860	1.660	1.637	1.591
Community College District	0.381	0.372	0.376	0.377	0.356	0.354	0.347	0.311	0.307	0.280
School Finance Authority.....	0.150	0.265	0.296	0.291	0.270	0.268	0.255	0.223	0.223	0.177
Chicago Park District	0.778	0.741	0.730	0.721	0.665	0.653	0.627	0.572	0.567	0.545
Water Reclamation District.....	0.471	0.495	0.495	0.492	0.451	0.444	0.419	0.415	0.401	0.371
Cook County	0.971	0.993	0.994	0.989	0.919	0.911	0.854	0.824	0.746	0.690
Cook County Forest Preserve.....	<u>0.072</u>	<u>0.073</u>	<u>0.072</u>	<u>0.074</u>	<u>0.074</u>	<u>0.072</u>	<u>0.070</u>	<u>0.069</u>	<u>0.067</u>	<u>0.061</u>
Other Unit Subtotal	<u>\$5.051</u>	<u>\$5.097</u>	<u>\$5.094</u>	<u>\$5.126</u>	<u>\$4.759</u>	<u>\$4.700</u>	<u>\$4.432</u>	<u>\$4.074</u>	<u>\$3.948</u>	<u>\$3.715</u>
TOTAL	<u>\$9.374</u>	<u>\$9.264</u>	<u>\$9.345</u>	<u>\$9.453</u>	<u>\$8.843</u>	<u>\$8.872</u>	<u>\$8.536</u>	<u>\$7.788</u>	<u>\$7.692</u>	<u>\$7.277</u>

(1) Source: Cook County Clerk's Office – tax rates by levy year.

(2) The 1995 Amendatory Act changed the tax rate limitations by consolidating the funds for special education, agricultural science, building, playground and recreational, textbook and teachers pension into the educational fund. Subsequent School Code amendments made this consolidation permanent.

TAX MATTERS

General

The Internal Revenue Code of 1986 (the “Code”) contains a number of requirements and restrictions that apply to the Bonds from and after the date of issuance, including investment restrictions, periodic payments of arbitrage profits to the United States, requirements regarding the use of Bond proceeds and the facilities financed or refinanced therewith, and certain other matters. The Board has covenanted to comply with all requirements of the Code that must be satisfied in order for interest on the Bonds to be excludable from gross income for federal income tax purposes. Failure to comply with certain of such requirements could cause interest on the Bonds to become includable in gross income retroactive to the date of issuance of the Bonds.

Subject to the condition that the Board complies with the foregoing covenants, under present law, in the opinion of Co-Bond Counsel the Bonds are not “private activity bonds” under the Section 141 of Code, and interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes. Interest on the Bonds will not be included as an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds will be taken into account, however, in computing an adjustment used in determining the alternative minimum tax for certain corporations and in computing the “branch profits tax” imposed on certain foreign corporations.

In rendering its opinion, Co-Bond Counsel will rely upon certifications of the Board with respect to certain material facts solely within the Board’s knowledge relating to the facilities to be financed or refinanced with the Bonds, the application of the proceeds of the Bonds and certain other matters pertinent to the tax exemption of the Bonds.

Interest on the Bonds is not exempt from income taxes currently imposed by the State of Illinois.

Co-Bond Counsel have not undertaken to advise in the future whether any events after the date of issuance of the Bonds may affect the tax status of interest on the Bonds. No assurance can be given that future legislation, or amendments to the Code, if enacted into law, will not contain provisions which could directly or indirectly reduce the benefit of the exclusion of the interest on the Bonds from gross income for federal income tax purposes.

Pursuant to Section 103 of the Code, interest on the Bonds is not includable in the gross income of the owners thereof for federal income tax purposes. However, the Code contains a number of other provisions relating to the treatment of interest on the Bonds which may affect the taxation of certain types of owners, depending on their particular tax situations. **PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISORS CONCERNING THE PARTICULAR FEDERAL INCOME TAX CONSEQUENCES OF THEIR OWNERSHIP OF THE BONDS.**

Bonds Purchased at a Premium or a Discount

The difference (if any) between the initial price at which a substantial amount of the Bonds is sold to the public (the “Offering Price”) and the principal amount payable at maturity of such Bonds is given special treatment for federal income tax purposes. If the Offering Price is higher than the maturity value of a Bond, the difference between the two is known as “bond premium” if the Offering Price is lower than the maturity value of a Bond, the difference between the two is known as “original issue discount.”

Bond premium and original issue discount are amortized over the term of a Bond on the basis of the owner's yield from the date of purchase to the date of maturity, compounded at the end of each accrual period of one year or less with straight line interpolation between compounding dates, as provided more specifically in the Income Tax Regulations. The amount of bond premium accruing during each period is treated as a reduction in the amount of tax-exempt interest earned during such period and is subtracted from the owner's tax basis in the Bond. The amount of original issue discount accruing during each period is treated as interest that is excludable from the gross income of the owner of such Bond for federal income tax purposes, to the same extent and with the same limitations as current interest, and is added to the owner's tax basis in the Bond. A Bond's adjusted tax basis is used to determine whether, and to what extent, the owner realizes taxable gain or loss upon disposition of the Bond (whether by reason of sale, acceleration, redemption prior to maturity or payment at maturity of the Bond).

Owners of Bonds should consult their own tax advisors with respect to the state and local tax consequences of owning the Bonds. It is possible that under the applicable provisions governing the determination of state or local income taxes, accrued interest on the Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment until a later year.

RATINGS

The Series 2003D-2 Bonds, the Series 2003D-3 Bonds and the Series 2003D-4 Bonds have received ratings of "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. ("Standard & Poor's"), "AAA" by Fitch, Inc. ("Fitch") and "Aaa" by Moody's Investors Services ("Moody's") based on the Policies to be issued by XL Capital Assurance Inc.

The Bonds, including the Series 2003D-1 Bonds, have also received ratings of "A+" by Standard & Poor's, "A+" by Fitch and "A2" by Moody's based upon the creditworthiness of the Board and without regard to bond insurance or other credit enhancement.

A rating reflects only the view of the rating agency giving such rating. Any explanation of the significance of such ratings may be obtained only from the respective rating agency. There is no assurance that any such rating will be maintained for any given period of time or that any such rating may not be raised, lowered or withdrawn entirely by the respective rating agency if in its judgment circumstances so warrant. Any change in or withdrawal of any such rating may have an effect on the price at which the Bonds may be resold.

FINANCIAL STATEMENTS

The financial statements of the Board as of and for the fiscal year ended June 30, 2002, included in APPENDIX-A to this Official Statement, have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report included in APPENDIX-A.

The Board expects to approve its audited financial statements for the fiscal year ended June 30, 2003, on or about December 17, 2003. When made available by the Board, the fiscal year 2003 financial statements may be requested.

FINANCIAL ADVISORS

The Board has engaged A.C. Advisory, Inc., Kirkpatrick Pettis, and PTW & Co., Ltd. as Financial Advisors in connection with the authorization, issuance and sale of the Bonds. The Financial

Advisors have provided advice on the plan of financing and structure of the Bonds and have reviewed certain legal documents, including this Official Statement, with respect to financial matters. Unless indicated to the contrary, the Financial Advisors have not independently verified the factual information contained in this Official Statement, but have relied on the information supplied by the Board and other sources.

UNDERWRITING

Lehman Brothers Inc., as Representative of the Underwriters identified on the cover page of this Official Statement, has agreed to purchase the Bonds at an aggregate purchase price of \$256,614,187.99 (which represents par, less an Underwriters' discount of \$1,310,812.01). The Bonds will be offered to the public at the price of par, as set forth on the inside cover page of this Official Statement. The Underwriters reserve the right to join with dealers and other Underwriters in offering the Bonds to the public.

The obligation of the Underwriters to accept delivery of and pay for the Bonds is subject to various conditions set forth in the Contract of Purchase relating to the Bonds, including, among others, the delivery of specified opinions of counsel and a certificate of the Board that there has been no material adverse changes in its conditions (financial or otherwise) from that set forth in this Official Statement.

CERTAIN LEGAL MATTERS

Issuance of the Bonds is subject to the issuance of the approving legal opinions of Ungaretti & Harris LLP and Pugh, Jones & Johnson, P.C., both of Chicago, Illinois, as Co-Bond Counsel. The proposed form of such opinion is included herein as APPENDIX-C. Certain legal matters will be passed upon for the Board by Ruth M. Moscovitch, General Counsel, and by Piper Rudnick LLP, Chicago, Illinois; and for the Underwriters by their Co-Counsel, Vedder, Price, Kaufman & Kammholz, P.C. and Sanchez & Daniels, both of Chicago, Illinois.

LITIGATION

General

The Board is involved in numerous lawsuits that arise out of the ordinary course of operating the school system, including, but not limited to, the lawsuits described in this Official Statement. Some of the cases pending against the Board involve claims for substantial monies. As is true with any complex litigation, neither the Board nor its counsel is able to predict either the eventual outcome of such litigation or its impact on the Board's finances. The Board has available to it a tort liability tax levy to pay tort judgments and settlements. This tort liability tax levy is unlimited as to rate, but subject to the limitations on the annual growth in property tax extensions of the Board imposed by the Property Tax Extension Limitation Law of the State, as amended. See "THE REAL PROPERTY TAX SYSTEM—Property Tax Extension Limitation Law; Issuance of Alternate Bonds."

Upon delivery of the Bonds, the Board will furnish a certificate to the effect that, among other things, there is no litigation pending in any court seeking to restrain or enjoin the issuance or delivery of the Bonds, or in any way contesting the validity or enforceability of the Bonds.

Pension Funding Litigation

In 1993, the Public School Teachers' Pension and Retirement Fund ("Fund") filed a lawsuit claiming that the Board failed to make certain statutorily required contributions to the Fund in the fiscal years ending August 31 of 1992, 1993 and 1994. The Fund's complaint alleges three basic claims: First, that the amounts paid to the Fund by the Board with respect to teachers working in federal programs for which it receives federal funds, do not count as employer contributions under the Pension Code, notwithstanding that employee contributions for such teachers do count. The amounts of money implicated in the fiscal years 1991, 1992, and 1993 were \$7,972,439, \$8,473,930 and \$10,158,343 respectively. The Fund's second claim involves employer contributions made by the Board for teachers electing early retirement. The Board contributed \$22,208,683.59 in August 1993 on behalf of those employees who elected early retirement that month. This contribution was paid under the lump sum plan for a number of retirees and under the installment plan (i.e., quarterly payments over a five-year period) for the remaining retirees. The Fund claims that this payment did not count as an employer contribution for purposes of the Pension Code even though the teacher contributions are deemed employee contributions. Based on this assertion, the Fund would have the Board make a "double" payment of the employer contribution. The Fund's third claim concerns the Pension Code provision which allows retired teachers to purchase constructive service credit for time spent in military service (either before becoming a teacher or after leaving the Board). The Pension Code requires retired teachers to pay all costs to the Fund for such added credit that is "an amount equal to the employer's normal cost of benefits accrued from such service plus interest." The Fund, however, contends that the payments for military service credits including the employer's normal cost of benefits are employee contributions, totaling \$1,633,476 and \$17,122 in fiscal years 1992 and 1993.

In December, 1996, the Board sought partial summary judgment determinative that the payments made to the Fund as employer contributions for teachers taking early retirement and that its payments to the Fund for teachers in federally-assisted programs are employer contributions for purposes of the deficiency provision of the Pension Code. Further, the motion sought a determination that retired teachers' payments for military service credit should not be treated as employee contributions requiring an employer match.

On February 28, 1997, the Circuit Court of Cook County granted the Board's partial Motion for Summary Judgment in all material aspects. The court reserved for later resolution the question whether the Board would owe interest on certain employee contributions for employees retiring early for alleged late payment. No final judgment has been rendered by the court in this case as of the date hereof. The Board has undertaken settlement discussions with the Fund in order to resolve this matter.

Teacher Tenure Litigation

Maurice Land, et al. v. Board of Education of the City of Chicago, et al., is a lawsuit filed in 1999 against the Board in which the plaintiffs are teachers laid-off pursuant to the Board's policy on reassignment and layoff of regularly appointed and certified teachers. Some of the plaintiffs were those who lost their assignments during the 1997 reconstitution of seven high schools. The complaint is for mandamus, declaratory and injunctive relief. The complaint asserts violation of the School Code provision relating to tenure. The trial court granted the Board's motion for summary judgment and the Chicago Teachers Union ("CTU") sought review in the Illinois Appellate Court.

On August 27, 2001, the Appellate Court issued an opinion affirming in part and reversing in part the Circuit Court's decision. The Appellate Court concluded, among other things, that (i) the Board has the statutory power to layoff tenured teachers, including the plaintiffs, (ii) the Board complied with the policy in laying off the plaintiffs, and (iii) the layoffs did not violate plaintiffs' due process rights. With respect to each of these issues (and others), the Appellate Court affirmed the Circuit Court's grant of

summary judgment in favor of the Board. However, the Appellate Court also held that although “the Board may establish a layoff policy..., [the Board] may not through that policy delegate its absolute layoff power to school administrators.” The Court remanded the case for further proceedings related to the delegation issue and the factual issues relating to the employment record of one of the plaintiffs.

On September 17, 2001, the Board filed a Petition for Rehearing challenging the Appellate Court’s ruling on the delegation issue, which was denied on October 20, 2001. Thereafter, on February 6, 2002, the Illinois Supreme Court granted the Board’s petition seeking appeal of the Appellate Court’s decision. On November 21, 2002, the Illinois Supreme Court, among other things, affirmed the Appellate Court’s holding that tenured teachers can be laid off, and agreed that the Board could delegate its layoff authority. However, the Illinois Supreme court also held that the Board was prohibited from delegating its layoff authority to school principals, and explicitly did not decide “whether the [layoff] authority may be delegated to officers or administrators other than the general superintendent and attorney.” The case was remanded to the Circuit Court “for further fact finding to determine whether the Board properly delegated responsibility for making any or all of the determinations required by the policy and, if so, whether the party to whom authority was delegated acted in accordance with the policy.”

Should the CTU ultimately prevail, the Court could order reinstatement and back wages for all of the Plaintiffs. The total amount of exposure may be significant, depending on the length of time that passes from the date of the layoff to the date of an ordered reinstatement. Given the current status of these matters, it is impossible to determine whether an ultimate finding of liability against the Board is probable or the exact cost associated with any such finding.

Jones, et. al. v. Board of Education 00 CH 093 74 is an action brought by the CTU essentially repeating the claims asserted in Land. Based upon the decision in a previous matter and the pendency of Land, the Board filed a motion to stay this action, arguing that the legal and factual issues raised in this action will be resolved *in toto* by the final decisions in the previously filed lawsuits. The Court granted the Board’s motion on August 16, 2000, granting a stay of Jones in all respects. It is unlikely that this action would give rise to liability not contemplated in the discussion of the Land litigation.

Principal Tenure Litigation

Michael Jacobson, Alvin Miller, et al. v. Board of Education is a class action brought on behalf of formerly tenured school principals who lost their positions pursuant to the provisions of Public Act 85-1418. The class was certified on September 15, 1997.

Public Act 85-1418, which became effective May 1, 1990, provided that the newly created Local School Councils (“LSC”) had the power to select the principals of their schools; pursuant to this authority, they could choose to replace formerly tenured principals who had been assigned to their schools prior to the enactment of the statute giving LSC this authority. On November 30, 1990, the Illinois Supreme Court held that Public Act 85-1418 was unconstitutional in its entirety for reasons unrelated to principal selection. The legislature replaced the unconstitutional act with Public Act 86-1477, effective January 11, 1991; the new act contained substantially the same language as the old regarding principal selection.

In Jacobson, the plaintiffs alleged that all tenured principals who lost their positions between April 15, 1990 and January 11, 1991 were injured in violation of certain contractual rights and were, therefore, entitled to back salary and compensation for lost benefits from the date they were terminated through January 11, 1991. On October 14, 1999, the Circuit Court granted summary judgment in favor of the Board, agreeing with the Board’s argument that plaintiffs had no contract with the Board, and thus no basis for their breach of contract claim against the Board.

The plaintiffs appealed, and the Appellate Court found that plaintiffs had pled “an employment relationship” that was “inherently” contractual. Based upon this conclusion, the Appellate Court entered judgment as to liability in favor of the plaintiffs. The case has been remanded to the trial court for a determination of the amount of damages owed to the plaintiffs.

Wrongful Death Claim

In Della Coleman, as Special Administrator of the Estate of Derrick Spencer v. Board of Education, the family of Derrick Spencer, an eighth grade student, filed suit against the Board and Quality Inn Hotels for damages arising from Derrick’s drowning while on a field trip along with other eighth grade students from Goldblatt Elementary School. The drowning occurred in Ohio on May 24, 2003, after one of Derrick’s classmates pushed him into the pool at the Quality Inn Hotel. The suit alleges that the Board was negligent in numerous respects, including: failing to provide lifeguards in connection with the swimming at Quality Inn Hotel; failing to assess Derrick’s swimming skills; failing to monitor the Goldblatt students in and around the pool; failing to follow Board policies regarding school trips; and failing to protect Derrick from the dangerous water conditions at the Quality Inn.

The Board will raise tort immunities as a defense to these claims, but the outcome of such a defense cannot be predicted. To the extent that the case results in a jury trial, a finding of liability on the part of the Board cannot be predicted as either probable nor remote at this juncture.

Dispute Over Pension Fund Claims for Reimbursement

A dispute exists between the Board and the Public School Teachers’ Pension and Retirement Fund (the “Fund”) regarding whether the Board has the right under the Illinois Pension Code, to require employees who want to take advantage of the Early Retirement Option (“ERO”) to apply for it by the middle of May of any year that the ERO is offered to teachers. The Board is required to contribute a specified amount to the Fund for each employee selecting the ERO.

The Fund has notified the Board of its position that the Board does not have a right to impose a deadline date on eligible employees to apply for the ERO. The Fund has represented that it intends to reach out to those employees who would have been eligible for the ERO under its analysis and offer them the opportunity to retire. Under this scenario, thirty percent (30%) of all teachers who have reached the age of 55 years and have at least 20 years, but less than 34 years, of service credit would be able to take advantage of the ERO in the years it was authorized by the Board. The Fund has also represented that it will send the Board an invoice for the Board’s contribution, and would also, if the Board refuses to pay, take legal action. No legal action has been taken by the Fund against the Board as of the date of this Official Statement.

Should the Fund’s interpretation be found correct in a court action, the Board will be required to pay the Fund the specified contribution for each employees who elects the ERO. While it is not possible to know with any certainty the number of employees who will elect the ERO under these circumstances, if the maximum number (30% of eligible employees) take advantage of it, the Board’s estimated liability could be approximately \$38,000,000. The Board is unable to predict the outcome of this dispute at the present time.

CONTINUING DISCLOSURE UNDERTAKING

The Board will enter into a Continuing Disclosure Undertaking (the “Undertaking”) for the benefit of the Beneficial Owners of the Bonds to send certain information annually and to provide notice of certain events to certain information repositories pursuant to the requirements of Section (b)(5) of Rule

15c2-12 (the “Rule”) adopted by the Securities and Exchange Commission (the “Commission”) under the Securities Exchange Act of 1934.

The Board is in compliance with undertakings previously entered into by it pursuant to the Rule. A failure by the Board to comply with the Undertaking will not constitute an event of default under the Resolutions or the Indenture, and Beneficial Owners of the Bonds are limited to the remedies described in the Undertaking. See “Consequences of Failure of the Board to Provide Information.”

The following is a brief summary of certain provisions of the Undertaking and does not purport to be complete. The statements made under this caption are subject to the detailed provisions of the Undertaking, copies of which are available upon request from the Board.

Annual Financial Information Disclosure

The Board covenants that it will disseminate its Annual Financial Information and its Audited Financial Statements, if any (as described below) to each Nationally Recognized Municipal Securities Information Repository (each, a “NRMSIR”) then recognized by the Commission for purposes of the Rule and to any public or private repository designated by the State as the state depository (the “SID”) and recognized as such by the Commission for purposes of the Rule. The Board is required to deliver such information so that such entities receive the information by the dates specified in the Undertaking.

“Annual Financial Information” means historical information generally consistent with information of the type set forth in this Official Statement under the following headings:

BOARD OF EDUCATION OF THE CITY OF CHICAGO:

School System

General Operating Fund Revenues, Expenditures, Other Financing Sources and Changes in Fund Balances for the Board

Board’s Debt Service Schedule

The Annual Financial Information, excluding the Audited Financial Statements, will be provided to each NRMSIR and to the SID, if any, 210 days after the last day of the Board’s fiscal year.

“Audited Financial Statements” means the general purpose financial statements of the Board which are in conformity with generally accepted accounting principles and audited by independent public accountants. The Audited Financial Statements will be provided to each NRMSIR and to the SID, if any, within 30 days after availability to the Board.

Events Notification; Material Events Disclosure

The Board covenants that it will disseminate to each NRMSIR or to the Municipal Securities Rulemaking Board (the “MSRB”) and to the SID, if any, in a timely manner the disclosure of the occurrence of an Event (as described below) that is material, as materiality is interpreted under the Securities Exchange Act of 1934, as amended. The “Events” are (i) debt service payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (vii) modifications to the rights of Bondholders;

(viii) bond calls; (ix) defeasances; (x) release, substitution or sale of property securing repayment of the Bonds; and (xi) rating changes.

Consequences of Failure to Provide Information

The Board shall give notice in a timely manner to each NRMSIR or to the MSRB and to the SID, if any, of any failure to provide disclosure of the Annual Financial Information and Audited Financial Statements when the same are due under the Undertaking.

A default under the Undertaking shall not be deemed an event of default under the Resolutions or the Indenture, and the sole remedy in the event of any failure of the Board to comply with the Undertaking shall be an action to compel performance. A failure by the Board to comply with the Undertaking must be reported in accordance with the Rule and must be considered by any broker, dealer or municipal securities dealer before recommending the purchase or sale of the Bonds in the secondary market. Consequently, such failure may adversely affect the transferability and liquidity of the Bonds and their market price.

Amendment; Waiver

Notwithstanding any other provision of the Undertaking, the Board may amend the Undertaking, and any provision thereof may be waived, if:

(a) (i) The amendment or the waiver is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Board, or type of business conducted;

(ii) The Undertaking, as amended, or the provision, as waived, would have complied with the requirements of the Rule at the time of the primary offering, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(iii) The amendment or waiver does not materially impair the interests of the Beneficial Owners of the Bonds, as determined by parties unaffiliated with the Board, (such as the Trustee or Bond Counsel), or by the approving vote of the owners of the Bonds pursuant to the terms of the Indenture at the time of the amendment; or

(b) The amendment or waiver is otherwise permitted by the Rule.

Termination of Undertaking

The Undertaking shall be terminated if the Board shall no longer have any legal liability for any obligation on or relating to repayment of the Bonds under the Indenture. If this provision is applicable, the Board shall each give notice in a timely manner to each NRMSIR or to the MSRB and to the SID, if any.

Dissemination Agent

The Board may, from time to time, appoint or engage a dissemination agent to assist it in carrying out its obligations under the Undertaking, and may discharge any such agent, with or without appointing a successor dissemination agent.

AUTHORIZATION AND MISCELLANEOUS

The Board has authorized the distribution of this Official Statement. This Official Statement has been duly executed and delivered on behalf of the Board.

**BOARD OF EDUCATION OF THE CITY OF
CHICAGO**

By: /s/ John Maiorca
Chief Financial Officer

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APPENDIX A

AUDITED FINANCIAL STATEMENTS FOR FISCAL YEAR 2002

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INDEPENDENT AUDITORS' REPORT

The Board of Education of the City of Chicago:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Chicago Public Schools (the Board of Education of the City of Chicago, the "CPS", a body politic and corporate of the State of Illinois) as of and for the year ended June 30, 2002, which collectively comprise the CPS' basic financial statements. These financial statements are the responsibility of the CPS' management. Our responsibility is to express an opinion on the respective financial statements based on our audit.

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

In our opinion, the respective financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Chicago Public Schools as of June 30, 2002, and the respective changes in financial position thereof and the respective budgetary comparison for the General Operating Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Deloitte & Touche LLP

November 22, 2002

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CHICAGO PUBLIC SCHOOLS
Management's Discussion and Analysis (MD&A)
June 30, 2002

INTRODUCTION

Our discussion and analysis of Chicago Public Schools' (CPS) financial performance provides an overview of the school district's financial activities for the fiscal year ended June 30, 2002. The intent of this management discussion and analysis is to look at CPS' financial performance as a whole; readers should also review the transmittal letter, financial statements and notes to the financial statements to enhance their understanding of CPS' financial performance.

This is the second year CPS has prepared its annual financial report using the new financial reporting model. The reporting model is a combination of both government-wide financial statements and fund financial statements. The basic financial statements contain three components:

- 1) Government-wide financial statements including the Statement Of Net Assets and the Statement Of Activities which provide a broad, long-term overview of CPS' finances,
- 2) Fund financial statements including the balance sheets that provide a greater level of detail of revenues and expenditures and focus on how well CPS has performed in the short term in the most significant funds, and
- 3) Notes to the financial statements.

This report presents the financial highlights for last year and contains other supplementary information.

OVERALL ANALYSIS

Chicago Public Schools is the third largest school district in the United States, serving over 438,000 students with an operating budget of almost \$3.57 billion and a capital budget of \$569 million. In general, the financial operations of CPS have performed well during uncertain financial times with varying financial indicators and results. In those revenue areas that are directly linked to the economy, CPS received lower revenues, but did not experience any major disruptions. On the expenditure side, CPS' monitoring of the budget resulted in a mid-year correction with administrative staff reductions and budget cuts which served to reduce overall expenditures. At the end of fiscal year 2002, CPS had a strong cash position. In September 2002, a bond ratings upgrade was received from Fitch Ratings.

In summary, CPS' overall financial position remains strong, stable and consistent. It should be noted that the positive financial performance was achieved even as the CPS implemented new educational programs to improve academic achievement.

FINANCIAL HIGHLIGHTS

Key financial highlights for 2002 are as follows:

- On the government-wide financial statements:
 - Total net assets of the CPS decreased from \$1.36 billion in fiscal year 2001 to \$1.16 billion in fiscal year 2002, a decrease of approximately \$200 million, or 14.7%.
 - Total revenues decreased \$31 million from \$3.86 billion in fiscal year 2001 to \$3.82 billion in fiscal year 2002, or 0.8%.

- Total expenses increased \$172 million from \$3.85 billion in fiscal year 2001 to \$4.02 billion in fiscal year 2002, or 4.5%.
- On the fund financial statements:
 - Ending fund balance of CPS decreased from \$1.35 billion in fiscal year 2001 to \$1.26 billion in fiscal year 2002, a decrease of \$86 million, or 6.4%.
 - However, in the General Operating Fund, unreserved funds increased from \$201 million in fiscal year 2001 to \$210 million in 2002, an increase of \$9 million, or 4.5%.
 - Total General Operating Fund budgeted resources and final appropriations exceeded actual revenues and expenditures by \$7.9 million primarily due to revenue shortfalls and the liquidation of prior period purchase orders.

OVERVIEW OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements are designed to provide readers with a broad overview of the school district's finances in a manner similar to a private sector business. The Statement of Net Assets and the Statement of Activities provide information about the activities of the school district as a whole, presenting both an aggregate and long-term view of the finances. These statements include all assets and liabilities using the accrual basis of accounting. This basis of accounting includes all of the current year's revenues and expenses regardless of when cash is received or paid.

The ***Statement of Net Assets*** presents information on all of CPS' assets and liabilities, with the difference between the two reported as *net assets*. Increases or decreases in net assets may serve as a useful indicator of whether the financial position is improving or deteriorating.

The ***Statement of Activities*** presents information showing how net assets changed during the fiscal year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of the related cash flows*. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but not used vacation leave).

Both of the government-wide financial statements distinguish functions of the CPS that are principally supported by taxes and intergovernmental revenues (*governmental activities*).

Financial Analysis of CPS as a Whole

All of CPS' services are reported in the government-wide financial statements, including instruction, pupil support services, instructional support services, administrative support services, facility support services, and food services. Property taxes, replacement taxes, state aid, and interest and investment earnings finance most of these activities. Additionally, all capital and debt financing activities are reported here.

Statement of Net Assets
(millions of dollars)

	Governmental Activities			
	2002	2001	Difference	% Change
Current assets	\$ 2,877	\$ 2,879	\$ (2)	0.0%
Capital assets, net	3,596	3,367	229	6.8
Total Assets	<u>\$ 6,473</u>	<u>\$ 6,246</u>	<u>\$ 227</u>	3.6
Current liabilities	\$ 765	\$ 701	\$ 64	9.1
Long-term liabilities	4,548	4,189	359	8.6
Total Liabilities	<u>\$ 5,313</u>	<u>\$ 4,890</u>	<u>\$ 423</u>	8.7
Net Assets:				
Invested in capital assets				
Net of related debt	\$ 401	\$ 445	\$ (44)	(9.9)
Debt service	480	410	70	17.1
Specific purposes	103	127	(24)	(18.9)
Unrestricted	176	374	(198)	(52.9)
Total Net Assets	<u>\$ 1,160</u>	<u>\$ 1,356</u>	<u>\$ (196)</u>	(14.5)

- **Total assets** increased due to new school construction and other improvement projects as part of the CPS' Capital Improvement Program.
- **Capital assets, net of depreciation** increased \$229 million or 6.8% over the prior year. This net increase represents \$410 million of additions, \$184 million of retirements and a \$2 million reduction of accumulated depreciation, net of \$138 million of current year depreciation. Capital assets, net of depreciation, for fiscal year 2001 totaled \$3.37 billion and \$3.6 billion in fiscal year 2002. The increase is due to the continued progress of the Capital Improvement Program.
- **Long-term liabilities** comprise three components:
 - **Long-term debt** increased \$254 million, or 9.9%. Total debt outstanding and capitalized in lease was \$3.44 billion in fiscal year 2001 and \$3.63 billion in fiscal year 2002. In fiscal year 2002, CPS issued \$217 million in Unlimited Tax Obligation Bonds (Series 2001C) and \$9 million in Qualified Zone Academy Bonds (Series 2001B) for continuation of the Capital Improvement Program.
 - **Accrued pension** increased to \$749.67 million in fiscal year 2002 from \$626.87 million in fiscal year 2001, an increase of \$122.8 million, or 19.6%.
 - **Other long-term liabilities** increased \$71 million, or 35.8%, due to a \$17 million legal judgment, and changes in CPS' policy for vacation and sick pay accrual and the procedures to estimate the liabilities.

Statement of Activities
(millions of dollars)

	Governmental Activities			
	2002	2001	Difference	% Change
Revenues:				
Program Revenues:				
Charges for services	\$ 11	\$ 11	\$ —	0.0%
Operating grants and contributions	688	702	(14)	(2.0)
Capital grants and contributions	160	251	(91)	(36.3)
Total Program Revenues	<u>\$ 859</u>	<u>\$ 964</u>	<u>\$ (105)</u>	(10.9)
General Revenues:				
Property taxes	\$ 1,533	\$ 1,460	\$ 73	5.0
Replacement taxes	114	138	(24)	(17.4)
State aid	1,227	1,160	67	(5.8)
Interest and investment earnings	68	104	(36)	(34.6)
Miscellaneous	23	29	(6)	(20.7)
Total General Revenues	<u>\$ 2,965</u>	<u>\$ 2,891</u>	<u>\$ 74</u>	2.6
Total Revenues	<u>\$ 3,824</u>	<u>\$ 3,855</u>	<u>\$ (31)</u>	(0.8)
Expenses:				
Instruction	\$ 2,438	\$ 2,244	\$ 194	8.6
Support services				
Pupil support	329	316	13	4.1
Administrative support	157	131	26	19.8
Facility support	335	396	(61)	(15.4)
Instructional support	340	324	16	4.9
Food services	169	173	(4)	(2.3)
Community services	48	74	(26)	(35.1)
Interest expense	183	172	11	6.4
Other	21	17	4	23.5
Total Expenses	<u>\$ 4,020</u>	<u>\$ 3,847</u>	<u>\$ 173</u>	4.5
Change in Net Assets	<u>\$ (196)</u>	<u>\$ 8</u>	<u>\$ (204)</u>	

Total revenues decreased \$31 million primarily due to the \$91 million decrease for Capital Grants and Contributions. In addition, replacement taxes and investment income decreased by \$23.4 million and \$35.5 million, respectively, due to the weakening economy. These decreases were offset by increases in property taxes and state aid totaling \$72.7 million and \$66.7 million, respectively.

Total expenses increased primarily due to the increases in salaries of \$94 million and \$31 million in hospitalization benefits costs. This increase was offset by lower interest expense on CPS' variable rate bonds which was originally budgeted at \$18.2 million but actual debt service was \$5.6 million, a savings of \$12.6 million.

Capital Assets

At June 30, 2002, the CPS had \$3.6 billion invested in a broad range of capital assets, including land, buildings and improvements, and equipment. This amount represents a net increase (including additions, deductions and depreciation) of \$228.3 million, or 6.8%, from last year (\$000's).

Governmental Activities						
	<u>2001</u>	<u>Additions</u>	<u>Retirements and Transfers to In-Service</u>	<u>2002</u>	<u>Difference</u>	<u>% Change</u>
Land	\$ 155,480	\$ 20,974	\$ (27)	\$ 176,427	\$ 20,947	13.5%
Buildings	4,752,286	311,381	(140,544)	4,923,123	170,837	3.6
Work in process	42,000	73,357	(42,000)	73,357	31,357	74.7
Equipment	<u>50,751</u>	<u>4,660</u>	<u>(1,852)</u>	<u>53,559</u>	<u>2,808</u>	5.5
Total Capital						
Assets	\$ 5,000,517	\$ 410,372	\$ (184,423)	\$ 5,226,466	\$ 225,949	4.5
Less:						
Accumulated depreciation . . .	<u>(1,633,080)</u>	<u>(138,265)</u>	<u>140,594</u>	<u>(1,630,751)</u>	<u>2,329</u>	0.1
Total Capital						
Assets, net	<u>\$ 3,367,437</u>	<u>\$ 272,107</u>	<u>\$ (43,829)</u>	<u>\$ 3,595,715</u>	<u>\$ 228,278</u>	6.8

Capital assets increased due to the purchases of land and the continued progress of the Capital Improvement Program.

Completion of new school construction as of June 30, 2002 included the following schools: William H. Byford School, Jenner Academy of the Arts, Sullivan Specialty School, Dawes New Area School, Wright Lab School, Northside College Preparatory School, and Chicago Military Academy-Bronzeville.

Long-term Debt and Capitalized Lease Obligations

As of June 30, 2002, the CPS had \$3.63 billion in total debt, including accreted interest, and capitalized lease obligations outstanding versus \$3.44 billion last year, an increase of 5.6%. A summary of the long-term debt and capitalized lease obligations are listed in the following table:

Governmental Activities (Millions of Dollars)					
	<u>2001</u>	<u>Issuances</u>	<u>Retirements</u>	<u>Accreted Interest</u>	<u>2002</u>
Unlimited Tax General Obligation Bonds	\$ 2,529	\$ 217	\$ (10)	\$ 39	\$ 2,775
Qualified Zone Academy Bonds	39	9	—	—	48
State Technology Revolving Loan	6	6	(2)	—	10
Asbestos Abatement Loans	<u>13</u>	<u>—</u>	<u>(1)</u>	<u>—</u>	<u>12</u>
Total	\$ 2,587	\$ 232	\$ (13)	\$ 39	\$ 2,845
Capitalized Lease Obligations	<u>855</u>	<u>—</u>	<u>(66)</u>	<u>—</u>	<u>789</u>
Total Debt	<u>\$ 3,442</u>	<u>\$ 232</u>	<u>\$ (79)</u>	<u>\$ 39</u>	<u>\$ 3,634</u>
Less: Current Year Portion and Premiums and Discounts					<u>(105)</u>
Total Long-Term Debt, Net					<u>\$ 3,529</u>

In December 2001, CPS issued \$217,260,000 in Unlimited Tax General Obligation Bonds Series 2001C. The proceeds from these bonds are being used as part of the CPS' Capital Improvement Program. As a result of the issuance, CPS recorded net proceeds of \$215,003,012 in the Capital Improvement Fund less the cost of issuance of \$2,256,988.

In October 2001, CPS issued \$9,440,000 in Qualified Zone Academy General Obligation Bonds (Series 2001B). The bonds were issued as "qualified zone academy bonds" within the meaning of Section 1397E of the Internal Revenue Code of 1986, as amended. CPS does not pay interest on the bonds, however, for federal income tax purposes, "eligible taxpayers", as defined in Section 1397E of the

Internal Revenue Code, who own the Series 2001B bonds will be entitled taxable income. Net proceeds of \$9,198,000 from these bonds are being used to renovate, rehabilitate and equip the qualified academies known as George Henry Corliss High School, John F. Kennedy High School, Wendell Phillips Academy High School, Senn High School, and William H. Wells Community Academy.

Debt issuances in fiscal year 2002 bring the total debt issued by CPS in connection with the Capital Improvement Program to \$4.0 billion.

In fiscal year 2002, the CPS entered into a promissory note for \$6 million with the Illinois State Board of Education as part of the State Technology Revolving Loan Program, the proceeds of which are to go toward the purchase of computers for schools. The term of the note is for three years at an interest rate of 2.5%.

The Chicago School Finance Authority (SFA) was created in January 1980 to exercise oversight and control over the financial affairs of the CPS. The SFA issued debt to fund construction and provide working capital. The principal amount of the SFA bonds outstanding as of June 30, 2002, net of bonds advance refunded or defeased, is \$458 million. The SFA bonds are not a direct or contingent obligation of the CPS and the 1995 Amendatory Act suspended the oversight powers of the SFA through fiscal year 2004.

In September 2002, Fitch Ratings upgraded CPS from an A to an A+, citing successful execution of the \$3.64 billion capital program and a strong local economy as factors. Moody's Investor Service reiterated its A2 rating and Standard and Poor's affirmed its A+ rating.

Pension Funding

Employees of the CPS participate in either the Public School Teachers' Pension and Retirement Fund of Chicago (the "Pension Fund") or the Municipal Employees Annuity and Benefit Fund of Chicago (the "Annuity Fund").

The CPS' employer-required contribution to the Pension Fund, with the exception of federal funds, is determined by State statutes. As of June 30, 2001, the funded ratio of the Pension Fund is approximately 99.9% and the CPS has recorded an estimated pension liability of \$749.67 million in the accompanying financial statements, as determined under generally accepted accounting principles. Because of the funded ratio, the CPS has no statutory employer-required contributions to the Pension Fund. The first year that CPS is expected to make a contribution to the Pension Fund under the statutory requirements is FY 2005.

All career service employees of the CPS, except CPS employees who are members of the Public School Teachers' Pension and Retirement Fund, participate in the Municipal Employees' Annuity and Benefit Fund of Chicago (the "Annuity Fund"). Covered employees are required by State statute to contribute 8.5% of their salary. In fiscal year 2002, as in previous fiscal years, the CPS agreed to pay a portion, 7%, or \$29.4 million of the required employees' contribution for most employees. No other employer contributions are made to the Annuity Fund by CPS.

OVERVIEW OF FUND FINANCIAL STATEMENTS

A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. CPS, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All CPS funds are reported in the governmental funds.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources, as well as on balances of spendable resources* available at

the end of the fiscal year for spending in future years. Such information may be useful in evaluating a government's near-term financing requirements.

These funds are reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. These statements provide a detailed short-term view of the school district's operations and the services it provides.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in the fund balance provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The CPS' fund financial statements provide detailed information about the most significant funds — not the CPS as a whole. The CPS' governmental funds use the following accounting approach. All of the CPS' services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year-end that are available for spending. They are reported using *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the CPS' operations and the services it provides.

CPS maintains three significant governmental funds: General Operating, Capital Projects, and Debt Service. The following schedule presents a summary of the general operating fund, capital projects fund and debt service fund revenues, and other financing sources by type for the period ended June 30, 2002 as compared to June 30, 2001. It also depicts the amount and percentage increases and decreases in relation to prior year revenues and other financing resources.

Revenues and Other Financing Sources

<i>(Millions of dollars)</i>	<u>2002 Amount</u>	<u>2001 Amount</u>	<u>2002 Percent of Total</u>	<u>Increase (Decrease) from 2001</u>	<u>Percent Increase (Decrease) from 2001</u>
Property taxes	\$ 1,480	\$ 1,430	36.9%	\$ 50	3.5%
Replacement taxes	114	138	2.8	(24)	(17.4)
State aid	1,468	1,432	36.6	36	2.5
Federal aid	555	634	13.9	(79)	(12.5)
Investment income	68	104	1.7	(36)	(34.6)
Other	<u>90</u>	<u>82</u>	<u>2.3</u>	<u>8</u>	<u>9.8</u>
Subtotal	\$ 3,775	\$ 3,820	94.2%	\$ (45)	(1.2)
Other financing sources	<u>233</u>	<u>472</u>	<u>5.8</u>	<u>(239)</u>	<u>(50.6)</u>
Total	<u>\$ 4,008</u>	<u>\$ 4,292</u>	<u>100.0%</u>	<u>\$ (284)</u>	<u>(6.6)</u>

- **Property taxes** increased by \$50 million from fiscal year 2001 due to a growing tax base and increases in tax levies which are subject to state legislated caps.
- **Personal property replacement taxes** decreased \$24 million from fiscal year 2001, due to the downturn in the economy.
- **State aid** revenues increased due to increases in the foundation level and increased Capital Development Board grants. The unrestricted portion of general state aid has increased 50% since 1998.

- **Federal aid** decreased by \$79 million due to reductions in E-Rate revenue and grant funding and subsidies of \$43 million and \$36 million, respectively.
- **Investment income** decreased by \$36 million due to lower interest rates.

The following schedule represents a summary of the General Operating Fund, Capital Projects Fund, and Debt Service Fund expenditures for the fiscal year ended June 30, 2002 and 2001, and the percentage increase and decrease in relation to prior year amounts.

Expenditures

<u>(Millions of dollars)</u>	<u>2002 Amount</u>	<u>2001 Amount</u>	<u>2002 Percent of Total</u>	<u>Increase (Decrease) from 2001</u>	<u>Percent Increase (Decrease) from 2001</u>
Instruction	\$ 2,153	\$ 1,995	52.6%	\$ 158	7.9%
Pupil support services	312	303	7.6	9	3.0
General support services	750	732	18.3	18	2.5
Food services	160	166	3.9	(6)	(3.6)
Community services	47	74	1.2	(27)	(36.5)
Teachers' pension	65	65	1.6	—	0.0
Capital outlay	381	528	9.3	(147)	27.8
Debt service	220	195	5.4	25	12.8
Other	5	17	0.1	(12)	(70.6)
Total	<u>\$ 4,093</u>	<u>\$ 4,075</u>	<u>100.0%</u>	<u>\$ 18</u>	<u>0.4</u>

- **Instruction** increased primarily due to:
 - Salaries which increased \$51 million due to teacher salary step increases, cost of living adjustments and the hiring of additional teachers;
 - Employee medical and hospitalization costs which increased \$31 million due to higher provider costs and more employees, and;
 - Textbook spending which increased \$4 million to support the new system-wide reading initiative by providing library books in every classroom from kindergarten through third grade.
- **Community services** decreased as amounts were reappropriated to other school based programs.
- **Capital outlay** decreased by \$147 million. The decrease in capital outlay of almost 28% is due to the near completion of many capital projects.
- **Debt service** expenditures have increased in response to the higher level of debt that the CPS has incurred to fund capital improvements.
- **Total expenditures** increased \$18 million from \$4.075 billion in fiscal year 2001 to \$4.093 billion in fiscal year 2002, or an increase of 0.4%.

Notes to Financial Statements

The Notes to Financial Statements follow the statements in the report and complement the financial statements by describing qualifying factors and changes throughout the fiscal year.

BUDGETARY HIGHLIGHTS

Annual budgets are prepared on a basis consistent with accounting principles generally accepted in the United States for the General Operating, Capital Project and Debt Service funds. All annual unencumbered appropriations lapse at fiscal year-end.

The appropriated budget is prepared by fund, account, and unit. Certain funding allocations (primarily Federal and State programs, including Supplementary General State Aid) are made to schools but are not budgeted by account by the schools at the time the budget is adopted. These allocations are included in Other Fixed Charges for budget purposes. During the fiscal year, upon receiving the appropriate approvals from regional offices and the Office of Management and Budget, transfers are made to the appropriate accounts. Actual expenditures are reflected in the appropriate accounts.

- In June 2001, the Board adopted a balanced budget for fiscal year 2002 that reflected total resources, including \$39.9 million of available fund balances, and appropriations of \$3.58 billion for the General Operating Fund.
- Actual General Operating Fund revenues for fiscal year 2002 were \$3.45 billion and actual general operating fund expenditures were \$3.49 billion. Actual revenues were less than budgeted revenues primarily due to revenue shortfalls from certain federal grants. These unspent grant amounts typically rollover to the next grant year.
- In June 2002, the Board adopted a balanced budget for fiscal year 2003 that reflected total resources, including \$43.7 million of available fund balances, and appropriations of \$3.67 billion for the General Operating Fund.

REQUESTS FOR INFORMATION

This financial report is designed to provide citizens, taxpayers, parents, students, investors and creditors with a general overview of the CPS' finances and to show the CPS' accountability for the money it receives. Additional details can be requested by mail at the following address:

The Chicago Public Schools
Office of the Controller
125 South Clark Street
14th Floor
Chicago, Illinois, 60603

Or visit our website at: <http://www.cps.k12.il.us> for a complete copy of this report and other financial information.

CHICAGO PUBLIC SCHOOLS
Chicago Board of Education

STATEMENT OF NET ASSETS
June 30, 2002
(Thousands of Dollars)

	Governmental Activities
ASSETS:	
Cash and investments	\$ 601,591
Cash and investments in escrow	969,770
Cash and investments held in school internal accounts	32,044
Property taxes receivable, net of allowance	823,834
Other receivables:	
Replacement taxes	16,948
State aid	300,752
Federal aid	97,321
Other	13,738
Other assets	21,074
Capital assets, net of accumulated depreciation	3,595,715
Total Assets	<u>\$ 6,472,787</u>
LIABILITIES:	
Accounts payable	\$ 236,650
Accrued payroll and benefits	364,979
Amount held for student activities	32,044
Other accrued liabilities	8,152
Interest payable	20,081
Current portion of long-term debt	103,077
Long-term liabilities:	
Debt, net of premiums and discounts	2,826,988
Capitalized lease obligations	702,026
Pension	749,667
Other benefits and claims	268,934
Total Liabilities	<u>\$ 5,312,598</u>
NET ASSETS:	
Invested in capital assets, net of related debt	\$ 400,731
Restricted for:	
Debt service	479,774
Specific purposes	103,372
Unrestricted	176,312
Total Net Assets	<u>\$ 1,160,189</u>

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

CHICAGO PUBLIC SCHOOLS
Chicago Board of Education

STATEMENT OF ACTIVITIES
For the Fiscal Year Ended June 30, 2002
(Thousands of Dollars)

	<u>Expenses</u>	<u>Charges For Services</u>	<u>Program Revenues</u> <u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Net (Expense) Revenue and Changes in Net Assets</u>
FUNCTIONS/PROGRAMS					
<i>Governmental activities:</i>					
Instruction	\$ 2,438,141	\$ —	\$ 350,444	\$ 102,009	\$ (1,985,688)
Support services:					
Pupil support services	329,041	—	19,447	14,765	(294,829)
Administrative					
support services . . .	156,583	—	31,328	7,026	(118,229)
Facility support					
services	334,605	—	12,771	14,309	(307,525)
Instructional support					
services	339,521	—	94,146	14,205	(231,170)
Food services	169,006	11,170	146,964	6,017	(4,855)
Community services . .	48,321	—	32,837	1,787	(13,697)
Interest expense	183,443	—	—	—	(183,443)
Other	21,253	—	—	—	(21,253)
Total Governmental					
Activities	<u>\$ 4,019,914</u>	<u>\$ 11,170</u>	<u>\$ 687,937</u>	<u>\$ 160,118</u>	<u>\$ (3,160,689)</u>
General Revenues:					
Taxes:					
Property taxes					\$ 1,532,662
Replacement taxes					114,313
State aid					1,227,052
Interest and investment income					68,050
Miscellaneous					22,814
Total General Revenues					<u>\$ 2,964,891</u>
Change in net assets					\$ (195,798)
Net assets — beginning					<u>1,355,987</u>
Net assets — ending					<u>\$ 1,160,189</u>

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

CHICAGO PUBLIC SCHOOLS**Chicago Board of Education****BALANCE SHEET — GOVERNMENTAL FUNDS****June 30, 2002****(Thousands of Dollars)**

	<u>General Operating Fund</u>	<u>Capital Projects Fund</u>	<u>Debt Service Fund</u>	<u>Totals</u>
ASSETS:				
Cash and investments	\$ 583,552	\$ 17,729	\$ 310	\$ 601,591
Cash and investments in escrow	1,226	574,256	394,288	969,770
Cash and investments held in school internal accounts	32,044	—	—	32,044
Receivables:				
Property taxes, net of allowance	793,131	—	30,703	823,834
Replacement taxes	16,948	—	—	16,948
State aid	290,686	—	10,066	300,752
Federal aid	97,155	166	—	97,321
Other	4,667	3,585	5,486	13,738
Due from other funds	53,544	923	49,374	103,841
Other assets	4,808	—	—	4,808
Total Assets	<u>\$ 1,877,761</u>	<u>\$ 596,659</u>	<u>\$ 490,227</u>	<u>\$ 2,964,647</u>
LIABILITIES AND EQUITY:				
LIABILITIES:				
Accounts payable	\$ 182,382	\$ 54,266	\$ —	\$ 236,648
Accrued payroll and benefits	345,513	—	—	345,513
Amount held for student activities	32,044	—	—	32,044
Due to other funds	—	103,841	—	103,841
Other accrued liabilities	4,000	4,152	—	8,152
Deferred property tax revenue	793,131	—	30,703	823,834
Other deferred revenue	155,557	—	—	155,557
Total Liabilities	<u>\$ 1,512,627</u>	<u>\$ 162,259</u>	<u>\$ 30,703</u>	<u>\$ 1,705,589</u>
EQUITY:				
Fund Balances:				
Reserved:				
Reserved for encumbrances	\$ 118,726	\$ 261,614	\$ —	\$ 380,340
Reserved for restricted donations	429	—	—	429
Reserved for specific purposes	36,096	—	—	36,096
Reserved for debt service	—	—	459,524	459,524
Unreserved:				
Designated to provide operating capital	201,500	—	—	201,500
Undesignated	8,383	172,786	—	181,169
Total Equity	<u>\$ 365,134</u>	<u>\$ 434,400</u>	<u>\$ 459,524</u>	<u>\$ 1,259,058</u>
Total Liabilities and Equity	<u>\$ 1,877,761</u>	<u>\$ 596,659</u>	<u>\$ 490,227</u>	<u>\$ 2,964,647</u>

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

CHICAGO PUBLIC SCHOOLS
Chicago Board of Education

RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET ASSETS
June 30, 2002
(Thousands of Dollars)

Total fund balances — governmental funds		\$ 1,259,058
Prepaid assets and deferred charges are recorded as expenditures in governmental funds. The Statement of Net Assets includes these amounts as other assets.		
Prepaid interest		9,628
Deferred charges — bond issuance costs		6,638
The cost of capital assets (land, buildings and improvements and equipment) purchased or constructed is reported as an expenditure in the governmental funds. The Statement of Net Assets includes those capital assets among the assets of the CPS as a whole. The cost of those capital assets are allocated over their estimated useful lives (as depreciation expense) to the various programs reported as governmental activities in the Statement of Activities. Because depreciation expense does not affect financial resources, it is not reported in the governmental funds.		
Costs of capital assets	\$ 5,226,466	
Accumulated depreciation	<u>(1,630,751)</u>	3,595,715
Long-term liabilities applicable to the CPS' governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. Interest payable on debt and other long-term obligations are not recorded in the governmental funds but they are reported in the Statement of Net Assets. All liabilities, both current and long-term, are reported in the Statement of Net Assets.		
Debt, net of premiums and discounts	\$ (2,843,121)	
Capitalized lease obligations	(788,974)	
Pension	(749,667)	
Other benefits and claims	<u>(288,398)</u>	
		(4,670,160)
Interest payable		(20,081)
Revenues that have been deferred in the governmental funds but are recognized as revenue in the government-wide financial statements.		
Deferred property tax revenue		823,834
Other deferred revenue		<u>155,557</u>
Net Assets		<u><u>\$ 1,160,189</u></u>

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

CHICAGO PUBLIC SCHOOLS

Chicago Board of Education

STATEMENT OF REVENUES, EXPENDITURES, OTHER FINANCING SOURCES (USES) AND CHANGES IN FUND BALANCES — GOVERNMENTAL FUNDS

For the Fiscal Year Ended June 30, 2002

With Comparative Amounts for the Fiscal Year Ended June 30, 2001

(Thousands of Dollars)

	General Operating Fund	Capital Projects Fund	Debt Service Fund	Total Fiscal Year Ended June 30, 2002	Total Fiscal Year Ended June 30, 2001
REVENUES:					
Property taxes	\$ 1,429,307	\$ —	\$ 50,661	\$ 1,479,968	\$ 1,429,871
Replacement taxes	57,193	—	57,120	114,313	137,744
State aid	1,336,586	—	131,328	1,467,914	1,431,777
Federal aid	539,573	15,177	—	554,750	634,094
Interest and investment income	16,505	33,074	18,471	68,050	103,520
Other	66,917	8,101	14,487	89,505	82,411
Total Revenues	<u>\$ 3,446,081</u>	<u>\$ 56,352</u>	<u>\$ 272,067</u>	<u>\$ 3,774,500</u>	<u>\$ 3,819,417</u>
EXPENDITURES:					
Current:					
Instruction	\$ 2,152,958	\$ —	\$ —	\$ 2,152,958	\$ 1,995,423
Pupil support services	311,628	—	—	311,628	303,071
Administration support services	148,297	—	—	148,297	125,930
Facilities support services	302,007	—	—	302,007	317,411
Instructional support services	299,807	—	—	299,807	286,846
Food services	160,063	—	—	160,063	166,365
Community services	47,523	—	—	47,523	73,718
Teacher's pension	65,045	—	—	65,045	65,045
Capital outlay	—	381,038	—	381,038	527,902
Debt service	1,420	—	218,474	219,894	195,310
Other	5,138	—	—	5,138	17,495
Total Expenditures	<u>\$ 3,493,886</u>	<u>\$ 381,038</u>	<u>\$ 218,474</u>	<u>\$ 4,093,398</u>	<u>\$ 4,074,516</u>
REVENUES IN EXCESS OF (LESS THAN) EXPENDITURES	<u>\$ (47,805)</u>	<u>\$ (324,686)</u>	<u>\$ 53,593</u>	<u>\$ (318,898)</u>	<u>\$ (255,099)</u>
OTHER FINANCING SOURCES (USES)					
Gross amounts from debt issuances	\$ —	\$ 232,693	\$ —	\$ 232,693	\$ 474,460
Net premiums/discounts	—	(9)	—	(9)	(2,644)
Transfers in/(out)	1,527	—	(1,527)	—	—
TOTAL OTHER FINANCING SOURCES (USES)	<u>\$ 1,527</u>	<u>\$ 232,684</u>	<u>\$ (1,527)</u>	<u>\$ 232,684</u>	<u>\$ 471,816</u>
REVENUES AND OTHER FINANCING SOURCES (USES) IN EXCESS OF (LESS THAN) EXPENDITURES					
Fund Balances, beginning of period	<u>\$ 411,412</u>	<u>\$ 526,402</u>	<u>\$ 407,458</u>	<u>\$ 1,345,272</u>	<u>\$ 1,128,555</u>
Fund Balances, end of period	<u>\$ 365,134</u>	<u>\$ 434,400</u>	<u>\$ 459,524</u>	<u>\$ 1,259,058</u>	<u>\$ 1,345,272</u>

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

CHICAGO PUBLIC SCHOOLS
Chicago Board of Education

**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGE IN FUND BALANCES WITH THE STATEMENT OF ACTIVITIES**
For the Fiscal Year Ended June 30, 2002
(Thousands of Dollars)

Total net change in fund balances — governmental funds	\$	(86,214)
Capital outlays to purchase or build capital assets are reported in governmental funds as expenditures. Governmental activities include these costs in the Statement of Net Assets. These costs are allocated over their estimated useful lives as annual depreciation expenses in the Statement of Activities. This is the amount by which capital outlays exceed the depreciation in the period.		
Capital outlay/equipment	\$	368,371
Depreciation expense	(138,265)	230,106
Proceeds from sales of bonds are reported in the governmental funds as a source of financing, whereas they are recorded as long-term liabilities in the Statement of Net Assets		(232,700)
Repayment of bond principal is an expenditure in the governmental funds, but it reduces long-term liabilities in the Statement of Net Assets and does not affect the Statement of Activities ..		76,901
Interest on long-term debt in the Statement of Activities differs from the amount reported in the governmental fund because interest is recorded as an expenditure in the governmental funds when it is due, and thus requires the use of current financial resources. In the Statement of Activities, however, interest cost is recognized as the interest accrues, regardless of when it is due		(40,447)
Bond discount, bond premium and issuance cost are amortized over the lives of the bonds in the Statement of Activities but are recorded as a reduction from the proceeds from sales of bond in the governmental funds		2,499
Since some property taxes and grants will not be collected for several months after the CPS' fiscal year ends, they are not considered as "available" revenues in the governmental funds, and are instead recorded as deferred revenues. They are, however, recorded as revenues in the Statement of Activities.		
Property taxes		52,694
Grants		(3,045)
In the Statement of Activities, only the gain on the sale of property is reported, whereas in the governmental funds, the entire proceeds from the sale increase financial resources. Thus the change in net assets differs from the change in fund balances by the original cost of the property sold		(27)
In the Statement of Activities, legal settlements, sick pay, vacation pay, workers' compensation, and net pension obligations are measured by the amount accrued during the year. In the governmental funds, expenditures for these items are measured by the amount actually paid.		
Tort judgments		(17,000)
Sick pay		(26,773)
Vacation pay		(26,456)
Workers' compensation		(2,534)
Net pension obligation		(122,802)
Change in Net Assets	\$	<u>(195,798)</u>

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

CHICAGO PUBLIC SCHOOLS
Chicago Board of Education

STATEMENT OF REVENUES, EXPENDITURES BY OBJECT
OTHER FINANCING SOURCES (USES) AND CHANGES IN FUND BALANCES
FINAL APPROPRIATIONS VS ACTUAL — GENERAL OPERATING FUND
For the Fiscal Year Ended June 30, 2002
(Thousands of Dollars)

	<u>Approved Budget</u>	<u>Transfers In/(Out)</u>	<u>Final Appropriations</u>	<u>Fiscal Year Actual</u>	<u>Variance</u>
REVENUES:					
Property taxes	\$ 1,421,400	\$ —	\$ 1,421,400	\$ 1,429,307	\$ 7,907
Replacement taxes	80,975	—	80,975	57,193	(23,782)
State aid	1,312,992	—	1,312,992	1,336,586	23,594
Federal aid	616,395	—	616,395	539,573	(76,822)
Interest and investment income	29,720	—	29,720	16,505	(13,215)
Other	73,800	—	73,800	66,917	(6,883)
Total Revenues	<u>\$ 3,535,282</u>	<u>\$ —</u>	<u>\$ 3,535,282</u>	<u>\$ 3,446,081</u>	<u>\$ (89,201)</u>
EXPENDITURES:					
Salaries —					
Teachers	\$ 1,671,652	\$ 17,351	\$ 1,689,003	\$ 1,690,449	\$ (1,446)
Career services	467,791	30,368	498,159	495,123	3,036
Commodities —					
Energy	60,234	(4,099)	56,135	53,453	2,682
Food	94,185	516	94,701	86,145	8,556
Textbooks	41,552	32,366	73,918	77,948	(4,030)
Supplies	28,864	17,169	46,033	40,655	5,378
Other	1,148	94	1,242	949	293
Services —					
Professional and construction	181,140	55,282	236,422	186,398	50,024
Transportation	90,883	12,973	103,856	95,502	8,354
Tuition	103,177	18,541	121,718	120,123	1,595
Telephone and telecommunications	7,606	(56)	7,550	24,880	(17,330)
Other	25,072	3,522	28,594	21,425	7,169
Equipment — Educational	25,300	26,731	52,031	51,947	84
Building and sites —					
Repairs and replacements	44,638	2,561	47,199	58,707	(11,508)
Capital outlay	—	106	106	118	(12)
Fixed charges —					
Teachers' pension	187,726	2,210	189,936	179,011	10,925
Career service pension	71,224	1,853	73,077	70,843	2,234
Hospitalization and dental insurance	177,615	16,801	194,416	192,342	2,074
Medicare	25,767	(710)	25,057	22,212	2,845
Unemployment compensation	2,103	18	2,121	2,336	(215)
Workers compensation	13,509	8	13,517	14,690	(1,173)
Rent	7,890	595	8,485	8,104	381
Debt service	1,500	—	1,500	1,420	80
Other	244,607	(234,200)	10,407	(894)	11,301
Total Expenditures	<u>\$ 3,575,183</u>	<u>\$ —</u>	<u>\$ 3,575,183</u>	<u>\$ 3,493,886</u>	<u>\$ 81,297</u>
REVENUES LESS THAN EXPENDITURES	\$ (39,901)	\$ —	\$ (39,901)	\$ (47,805)	\$ (7,904)
OTHER FINANCING SOURCES					
Transfers in	1,527	—	1,527	1,527	—
TOTAL OTHER FINANCING SOURCES					
REVENUES AND OTHER FINANCING					
SOURCES LESS THAN EXPENDITURES	\$ (38,374)	\$ —	\$ (38,374)	\$ (46,278)	\$ (7,904)
Fund Balances, beginning of period	411,412	—	411,412	411,412	—
Fund Balances, end of period	<u>\$ 373,038</u>	<u>\$ —</u>	<u>\$ 373,038</u>	<u>\$ 365,134</u>	<u>\$ (7,904)</u>

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

CHICAGO PUBLIC SCHOOLS

Chicago Board of Education

NOTES TO FINANCIAL STATEMENTS

June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Board of Education of the City of Chicago, or the Chicago Public Schools (CPS), is a body politic and corporate, and a school district of the State of Illinois having boundaries coterminous with the boundaries of the City of Chicago. The Board of Education of the City of Chicago (the Board) is established under and governed by the Illinois School Code and maintains a system of schools primarily for kindergarten through twelfth grade.

As a result of legislation passed by the Illinois General Assembly, which became effective on June 30, 1995, the Mayor of the City of Chicago appoints the members of the Board of Education of the City of Chicago. The CPS is excluded from the City's reporting entity because it does not meet the financial accountability criteria for inclusion established by the Governmental Accounting Standards Board Statement No. 14 (GASB No. 14).

The Chicago School Finance Authority, the Public Building Commission of Chicago and the Public School Teachers' Pension and Retirement Fund of Chicago are related but separate entities and are not included as part of the CPS reporting entity. These units are excluded from the CPS reporting entity because they do not meet the criteria for inclusion as established by GASB No. 14.

Description of Government-Wide Financial Statements

During fiscal year 2001, CPS adopted GASB Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*, issued June 1999; GASB Statement No. 37, *Basic Financial Statement — and Management's Discussion and Analysis — for State and Local Governments: Omnibus*, an amendment to GASB Statements No. 21 and No. 34, issued in June 2001, and; GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, issued in 2001.

The Statement of Net Assets and the Statement of Activities display information about the government-wide entity as a whole. The Statement of Net Assets and the Statement of Activities were prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Revenues, expenses, gains, losses, assets, and liabilities resulting from nonexchange transactions are recognized in accordance with the requirements of GASB Statement No. 33 "*Accounting and Financial Reporting for Nonexchange Transactions*."

Program revenues included in the Statement of Activities derive directly from the program itself or from parties outside the CPS's taxpayers or citizenry, as a whole; program revenues reduce the cost of the function to be financed from general revenues.

The CPS reports all direct expenses by function in the Statement of Activities. Direct expenses are those that are clearly identifiable with a function. Indirect expenses of other functions are not allocated to those functions but are reported separately in the Statement of Activities. Depreciation expense is specifically identified by function and is included in the direct expense to each function. Interest on general long-term debt is considered an indirect expense and is reported separately on the Statement of Activities.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Government-Wide and Fund Financial Statements

The government-wide financial statements report information on all of the activities of the CPS. The effect of interfund activity has been removed from these statements.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not identified as program revenues are reported as general revenues.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Property taxes are considered to be available if collected within 60 days of fiscal year end. For this purpose, the CPS considers revenues, other than property taxes, that are susceptible to accrual to be available if they are collected within 90 days of fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Funds

CPS reports its financial activities through the use of “fund accounting.” This is a system of accounting wherein transactions are reported in self-balancing sets of accounts to reflect results of activities. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds are maintained, consistent with legal and managerial requirements. A description of the activities of the various funds is provided below.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Governmental Funds

a. General Operating Fund

The General Operating Fund is established in compliance with the provisions of the Illinois Program Accounting Manual for Local Education Agencies. This Fund is the primary operating fund of CPS and is made up of the following programs:

- Educational Program
- Supplementary General State Aid Program
- School Food Service Program
- Improving America's Schools Act Program
- Education of the Handicapped Program
- Medicare Program
- Workers' and Unemployment Compensation/Tort Immunity Program
- Public Building Commission Operations and Maintenance Program
- Other Government-Funded Programs

b. Capital Projects Fund

The Capital Projects Fund includes the following programs:

Capital Asset Program — This program is for the receipt and expenditure of the proceeds from the sale of certain Board real estate, proceeds from the Chicago School Finance Authority, and other miscellaneous capital projects revenues from various sources as designated by the Board.

Capital Improvement Program — This program is for the receipt and expenditure of proceeds from the sale of Unlimited Tax General Obligation Bonds, Public Building Commission Building Revenue Bonds, State of Illinois Construction Grants, Federal E-rate capital subsidies and other revenues for the purpose of building and improving schools as designated by the Board. The bonds are being repaid in the Debt Service Fund from Replacement Tax revenue, from an Intergovernmental Agreement with the City of Chicago, State of Illinois Construction Grants, General State Aid, other revenues as designated by the Board and from a separate tax levy associated with the bonds, if necessary.

c. Debt Service Fund

The Debt Service Fund includes the following programs:

Bond Redemption and Interest Program — This program is for the receipt and expenditure of Replacement Taxes, City of Chicago Intergovernmental Agreement revenue, State of Illinois Construction Grants, General State Aid and other revenues as designated by the Board for the payment of interest and principal on specific bond issues.

Public Building Commission Leases Program — Receipts and expenditures of tax levies and State of Illinois Construction Grants for the rental payments due to the Public Building Commission of school buildings are recorded in this program. The title to these properties passes to the City of Chicago, in trust for the use of the CPS, at the end of the lease terms.

Assets, Liabilities, and Net Assets or Equity

Deposits and Investments

CPS' cash and cash equivalents consists of cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. In addition, state statutes authorize CPS to invest in obligations of the U.S. Treasury, commercial paper, repurchase agreements, and the State Treasurer's Investment Pool. CPS' investments are reported at fair value.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Restricted Assets

Certain proceeds of the CPS bond issuances, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

Receivables and Payables

The CPS records its property taxes receivable as levied for each levy net of an allowance for estimated uncollectible amounts. The allowance is recorded at 2.5% of the gross levy.

A calendar year's property tax levies are billed (extended) in two installments in the subsequent calendar year. Calendar year 2001 property taxes were levied for fiscal year 2002 in December 2001, and were be billed in fiscal year 2002. In 2002, the installment due dates were March 1 and November 1. Property taxes unpaid after these dates accrue interest at the rate of 1.5% per month. Collections of property tax installments are received by the treasurers of Cook and DuPage counties, who distribute such receipts to the CPS. The CPS' property tax becomes a lien on real property on January 1 of the year for which it is levied. The levy becomes an enforceable lien against the property as of January 1 of the levy year. CPS does not record a receivable nor related deferred revenue until the levy for the current fiscal year is passed by the Board.

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e. the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

Capital Assets

Capital assets, which include land, building, building improvements and equipment are reported in the governmental activities columns in the government-wide financial statements. Land, buildings and building improvements are recorded at historical cost or estimated historical cost if purchased or constructed. The capitalization threshold for equipment is a unit cost of \$25,000 or more. Donated capital assets are recorded at estimated fair market value at date of donation.

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

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Depreciation of buildings and building improvements of the CPS placed in service subsequent to fiscal year 2001 will be calculated using the straight line method beginning in the year after they are placed in service. Equipment is depreciated using the straight line method and the mid-year convention. The CPS' capital assets have the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and building improvements	25-50
Administrative software/systems	20
Equipment	5

Depreciation of buildings and building improvements placed in service prior to fiscal year 2002 was calculated using a composite rate that CPS estimated to be 32 years.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Vacation and Sick Pay

The CPS provides vacation and sick pay benefits for substantially all of its employees. Accrued sick pay benefits were computed using the termination payment method. In fiscal year 2002, the liability for accrued vacation pay benefits was computed using the employee's actual daily wage instead of average daily wage as used in prior years.

Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Balances and Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

The Statement of Net Assets include the following:

Investment in Capital Assets, net of Related Debt — the component of net assets that reports the difference between capital assets less both the accumulated depreciation and the outstanding balance of debt, excluding unexpended proceeds, that is directly attributable to the acquisition, construction or improvement of those assets.

Restricted for Specific Purposes — the component of net assets that reports the difference between assets and liabilities of the certain programs that consists of assets with constraints placed on their use by either external parties and / or enabling legislation.

Restricted for Debt Service — the component of net assets that reports the difference between assets and liabilities of the Debt Service Fund that consists of assets with constraints placed on their use by creditors.

Unrestricted — the difference between the assets and liabilities that is not reported as Net Assets Invested in Capital Assets, net of Related Debt, Net Assets Restricted for Specific Purpose, or Net Assets Restricted for Debt Service.

Comparative Data

Comparative total data for the prior year have been presented in the fund financial statements in order to provide an understanding of the changes in the financial position and operations of these funds.

Management's Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE 2. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets

Annual Budgets are prepared on a basis consistent with accounting principles generally accepted in the United States for the General Operating, Capital Projects and Debt Service funds. All annual unencumbered appropriations lapse at fiscal year-end.

Certain funding allocations (primarily Federal and State programs, including Supplementary General State Aid) are made to schools but are not budgeted by account by the schools at the time the budget is adopted. These allocations are included in Other Fixed Charges for budget purposes. During the fiscal year, upon receiving the appropriate approvals from regional offices and the Office of Management and Budget, transfers are made to the appropriate accounts. Actual expenditures are reflected in the appropriate accounts.

The appropriated budget is prepared by fund, account and unit. The legal level of budgetary control is at the account level except for school-based discretionary programs. School-based discretionary program expenditures are governed by specific program policies and procedures. Board approval is required for all funding transfers except those described above. In addition, an amended budget is required for increases in total appropriation.

In June 2001, the Board adopted a balanced budget for the fiscal year 2002 General Operating Fund that reflected total appropriations of \$3.58 billion. In June 2002, the Board adopted a balanced budget for the fiscal year 2003 General Operating Fund that reflected total appropriations of \$3.67 billion.

The Capital Projects Fund is budgeted on a project by project basis. Budgeted amounts in the Capital Projects Fund represent the entire project budget for projects that were expected to commence in fiscal year 2002. Actual expenditures in the Capital Projects Fund include expenditures on projects that were budgeted in the current and prior fiscal years.

NOTE 3. PROPERTY TAXES AND STATE AID REVENUE

a. Property Taxes — The CPS levies property taxes using tax levy rates established by statute and an equalized assessed valuation (“EAV”) estimated by the CPS. The maximum billing (extension) of property taxes for the rate-limited Educational Levy in any calendar year is limited to the lesser of the tax rate established by statute multiplied by the EAV known at the time the final calendar year tax bills are calculated by the Cook and DuPage County Clerks or the tax rates established by statute multiplied by the prior year EAV. Property taxes for the levies that are not rate-limited are levied based on the estimated requirements for such funds.

The CPS’ extensions are limited to the prior year EAV multiplied by the current year maximum legal rate limit. In addition, the growth in property tax extensions of the CPS is limited to the lesser of 5% or the percentage increase in the consumer price index for all urban consumers during the calendar year preceding the tax levy year. Extensions can be increased above this limitation due to the following increases: assessed valuation attributable to new construction, referendum approval, or rate limitation.

Amounts collected in excess of the estimated net receivable for each levy year are reported as revenue in the fiscal year that the tax collections are distributed to CPS. Such amounts are reflected as reductions to property tax receivables because current and future year tax distributions are also impacted by refunds paid by the county treasurers that reduce tax collections distributed to CPS.

NOTE 3. PROPERTY TAXES AND STATE AID REVENUE (continued)

Legal limitations on tax rates and the rates extended in calendar years 2002 and 2001 are shown below.

		Tax Rates	
	Maximum 2002	Extended Per \$100 of EAV	
	<u>Legal Limit</u>	<u>2002</u>	<u>2001</u>
General Operating Fund:			
Educational	(A)	\$ 2.712	\$ 2.755
Medicare	(B)	.031	.047
Workers' and Unemployment Compensation/Tort Immunity	(B)	.191	.141
Public Building Commission Operation and Maintenance	(B)	.685	.640
Public Building Commission Lease Program	(B)	<u>.125</u>	<u>.131</u>
		\$ 3.744	\$ 3.714

- A. The 2002 Educational tax rate is limited to the sum of \$3.62 per \$100 of EAV plus the difference (the "difference tax") between \$.50 per \$100 of EAV and the rate of taxes extended for the School Finance Authority.
- B. These tax rates are not limited by law, but are subject to the limits described previously.
- b. State Aid* — The components of State Aid as shown on the financial statements are as follows (\$000's):

	Fund Financial Statements	Government Wide Financial Statements
Revenues:		
Revenues:		
General State Aid Unrestricted	\$ 545,640	\$ 545,640
Supplementary General State Aid	261,000	261,000
State Teachers' Pension Funding	65,045	65,045
General Education Block Grant	114,696	114,696
Educational Services Block Grant	308,760	305,715
Capital Grants	109,397	109,397
Other Restricted State Revenue	63,376	63,376
Total State Aid	<u>\$ 1,467,914</u>	<u>\$ 1,464,869</u>

NOTE 4. CASH DEPOSITS AND INVESTMENTS

Cash and investments held in the name of the CPS are controlled and managed by the CPS' Treasury Department; however, custody is maintained by the Treasurer of the City of Chicago, who is the designated ex-officio Treasurer of the CPS under the Illinois School Code. Except for cash and investments in escrow, and the schools' internal accounts, all cash is deposited in bank accounts designated by the City Treasurer for the exclusive use of the CPS.

The cash and investments in escrow in the Debt Service Fund represent the amount available for debt service payments on the Unlimited Tax General Obligation Bonds and PBC Leases. The cash and investments in escrow in the Capital Projects Fund represent the unspent proceeds from the Unlimited Tax General Obligation Bonds, Public Building Commission Building Revenue Bonds, State Technology

NOTE 4. CASH AND INVESTMENTS (continued)

Revolving Loan Fund and other revenues. All cash and investments in escrow are deposited in trust accounts maintained by independent trustees.

The CPS Investment Policy and the Municipal Code of Chicago require collateral with an aggregate market value of not less than 110% of the original acquisition price, including principal and accrued interest, on all depository account balances and certificates of deposit. Repurchase agreement collateral shall not be less than 102%. Collateral shall be only those securities authorized as allowable investments. Collateral for the CPS' bank accounts are held by the Treasurer of the City of Chicago in the name of the Chicago Public Schools.

Cash

With the exception of school internal accounts as designated by the Board, the Municipal Code of Chicago requires that cash be deposited only in chartered banks or savings and loan associations that are on the City of Chicago's approved depository listing. The ordinances allow only regularly organized State or national banks insured by the Federal Deposit Insurance Corporation, and Federal and State savings and loan associations insured by the Savings Association Insurance Fund of the Federal Deposit Insurance Corporation located within the City of Chicago, to be designated depositories.

As of June 30, 2002, the book amount of the CPS' deposit accounts was \$2.33 million. The bank balance as of June 30, 2002, was \$33.29 million. The difference between the book and bank balances primarily represents checks that have been issued but have not yet cleared as of June 30, 2002. The bank balance was covered by Federal depository insurance and by collateral held by the CPS' agent.

Cash and Investments Held in School Internal Accounts, and the corresponding liability, Amounts Held for Student Activities, represent the individual schools bank balance for checking and investments.

Investments

Illinois Compiled Statutes authorize the CPS to invest in obligations guaranteed by the full faith and credit of the U.S. Government, certificates of deposit constituting direct obligations of banks, commercial paper rated within the three highest classifications established by at least two standard rating services, money market mutual funds that invest within the parameters of the CPS Investment Policy, repurchase agreements that mature within 330 days, certain U.S. Government agency securities and certain State and municipal securities, the payment of which is protected by the power to levy taxes. During the fiscal year ended June 30, 2002, deposits and repurchase agreements were supported by collateral with an aggregate market value equal to at least 110% and 102% respectively, of amounts deposited.

Investments as of June 30, 2002, are categorized to give an indication of custodial risk assumed by CPS.

NOTE 4. CASH AND INVESTMENTS (continued)

(\$000's)	Category			Carrying Amount
	<u>1</u>	<u>2</u>	<u>3</u>	
Repurchase Agreements	\$ 580,803	\$ —	\$ —	\$ 580,803
U.S. Government Agency Securities	514,716	—	—	514,716
Commercial Paper	60,251	—	—	60,251
Total	<u>\$ 1,155,770</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,155,770</u>
Money Market Mutual Funds				445,301
Total Investments				\$ 1,601,071
Cash				2,334
Total Cash and Investments				<u>\$ 1,603,405</u>

Investments are categorized into these three categories of credit risk:

- (1) Insured or registered, or securities held by the CPS or its agent in the CPS' name.
- (2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the CPS' name
- (3) Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent, but not in the CPS' name

The following table provides a summary of CPS' total cash and investments at June 30, 2002 (\$000's):

<u>Fund:</u>	<u>Amount</u>
General Operating Fund	\$ 616,822
Capital Projects Fund	591,985
Debt Service Fund	394,598
Total Cash and Investments	<u>\$ 1,603,405</u>

NOTE 5. RECEIVABLES

Receivables as of June 30, 2002 for the CPS, net of the applicable allowance for uncollectible accounts, are as follows (\$000's):

	<u>Fund Financial Statements</u>	<u>Government Wide Financial Statements</u>
Property taxes	\$ 863,133	\$ 863,133
Replacement taxes	16,948	16,948
State aid	300,752	300,752
Federal aid	97,321	97,321
Other	13,738	13,738
Total Receivables	\$ 1,291,892	\$ 1,291,892
Less: Allowance for uncollectibles	(39,299)	(39,299)
Total Receivables, net	<u>\$ 1,252,593</u>	<u>\$ 1,252,593</u>

NOTE 5. RECEIVABLES (continued)

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. At June 30, 2002, the various components of deferred revenue reported in the fund financial statements are as follows (\$000's):

Deferred property taxes	\$ 823,834
Educational services block grant	155,557
Total Deferred Revenue	<u>\$ 979,391</u>

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2002 was as follows (\$000's):

Government-wide activities:	Beginning Balance	Increases	Decreases and Transfers to In-service	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 155,480	\$ 20,974	\$ (27)	\$ 176,427
Construction in progress	42,000	73,357	(42,000)	73,357
Total capital assets not being depreciated	<u>\$ 197,480</u>	<u>\$ 94,331</u>	<u>\$ (42,027)</u>	<u>\$ 249,784</u>
Capital assets being depreciated:				
Buildings and improvements	\$ 4,752,286	\$ 311,381	\$ (140,544)	\$ 4,923,123
Equipment and administrative software ..	50,751	4,660	(1,852)	53,559
Total capital assets being depreciated ...	<u>\$ 4,803,037</u>	<u>\$ 316,041</u>	<u>\$ (142,396)</u>	<u>\$ 4,976,682</u>
Total Capital Assets	<u>\$ 5,000,517</u>	<u>\$ 410,372</u>	<u>\$ (184,423)</u>	<u>\$ 5,226,466</u>
Less accumulated depreciation for:				
Buildings and improvements	\$ (1,611,656)	\$ (131,832)	\$ 140,544	\$ (1,602,944)
Equipment and administrative software ..	(21,424)	(6,433)	50	(27,807)
Total accumulated depreciation	<u>\$ (1,633,080)</u>	<u>\$ (138,265)</u>	<u>\$ 140,594</u>	<u>\$ (1,630,751)</u>
Capital Assets, net of depreciation	<u>\$ 3,367,437</u>	<u>\$ 272,107</u>	<u>\$ (43,829)</u>	<u>\$ 3,595,715</u>

Depreciation expense was charged to functions/programs of the CPS as follows (\$000's):

Governmental activities:	
Instruction	\$ 88,149
Pupil support services	12,759
Administrative support services	6,072
Facility support services	12,366
Instructional support services	12,276
Food services	6,554
Community services	89
Total Depreciation	<u>\$ 138,265</u>

Construction Commitments

The CPS has active construction projects as of June 30, 2002. These projects include new construction and renovations of schools. At year end, the CPS had approximately \$261.61 million in outstanding construction encumbrances.

NOTE 7. INTERFUND TRANSFERS AND BALANCES

Interfund Transfers

Interfund transfers are defined as the flow of assets, such as cash or goods, without equivalent flows of assets in return. Interfund borrowings are reflected as “Due from/to Other Funds” on the accompanying governmental fund financial statements. All other interfund transfers are reported as operating transfers.

The following represent interfund balances among all funds at June 30, 2002 (\$000's):

General Operating Fund:	
Due from Capital Improvement Program	\$ 103,841
Due to Capital Asset Program	(923)
Due to Bond Redemption and Interest Program	(49,988)
Due from Public Building Commission Leases Program	614
Total — Due from other Funds	<u>\$ 53,544</u>
Capital Projects Fund:	
Capital Assets Program — Due from General Operating Fund	\$ 923
Capital Improvement Program — Due to General Operating Fund	(103,841)
Total — Due to other Funds	<u>\$ (102,918)</u>
Debt Service Fund:	
Bond Redemption and Interest Program — Due from General Operating Fund	\$ (49,988)
Public Building Commission Leases Program — Due to General Operating Fund	614
Total — Due from other Funds	<u>\$ 49,374</u>

These balances result from operating transactions between funds and are repaid during the fiscal year within the normal course of business.

Transfers

Effective June 30, 2002, CPS made operating transfers of \$2.1 million from the General Operating Fund to the Bond Redemption and Interest Program in order to fund principal payments related to outstanding State Technology Revolving Loans, and; transfer \$3.6 million of interest earnings from the Bond Redemption and Interest Program to the General Operating Fund.

NOTE 8. LONG-TERM DEBT

a. General Obligation Bonds

The CPS had the following bond issuances in fiscal year 2002:

Unlimited Tax General Obligation Bonds (Series 2001C)

In December 2001, CPS issued \$217,260,000 in Unlimited Tax General Obligation Bonds Series 2001C. The proceeds from these bonds are being used as part of the CPS' Capital Improvement Program. As a result of the issuance, CPS recorded net proceeds of \$215,003,012 in the Capital Projects Fund.

Qualified Zone Academy Bonds (Series 2001B)

In October 2001, CPS issued \$9,440,000 in Qualified Zone Academy General Obligation Bonds (Series 2001B). The bonds were issued as “qualified zone academy bonds” within the meaning of Sec-

NOTE 8. LONG-TERM DEBT (continued)

tion 1397E of the Internal Revenue Code of 1986, as amended. CPS does not pay interest on the bonds, however, for Federal income tax purposes, “eligible taxpayers,” as defined in Section 1397E of the Internal Revenue Code, who own the Series 2001B bonds will be entitled to a credit against taxable income. Net proceeds of \$9,198,000 from these bonds are being used to renovate, rehabilitate and equip the qualified zone academies known as George Henry Corliss High School, John F. Kennedy High School, Wendell Phillips Academy High School, Senn High School, and William H. Wells Community Academy.

*b. Other Long-term Debt*State Technology Revolving Loan (STRL)

In fiscal year 2002, the CPS entered into a promissory note for \$6,000,000 with the Illinois State Board of Education, the proceeds of which are to go toward the purchase of computers for schools. The term of the note is for three years at an interest rate of 2.5%.

The following is a summary of changes in Long-term Debt outstanding (\$000's):

Series	Principal Outstanding June 30, 2001	Issuances	Retirements	Principal Outstanding June 30, 2002	Accreted Interest	Principal and Accreted Interest June 30, 2002
2001C	\$ —	\$ 217,260	\$ —	\$ 217,260	\$ —	\$ 217,260
2001B	—	9,440	—	9,440	—	9,440
2001A	45,110	—	—	45,110	—	45,110
2000E	13,390	—	—	13,390	—	13,390
2000B,C,D	303,000	—	—	303,000	—	303,000
2000A	106,960	—	—	106,960	—	106,960
IDFA 1999A	12,000	—	—	12,000	—	12,000
1999A	532,554	—	—	532,554	54,425	586,979
1998B-1	328,714	—	—	328,714	66,895	395,609
1998	14,000	—	—	14,000	—	14,000
1997A	499,995	—	—	499,995	10,531	510,526
1997	491,945	—	(7,250)	484,695	—	484,695
1996	127,225	—	(2,360)	124,865	—	124,865
Total Bonds	\$ 2,474,893	\$ 226,700	\$ (9,610)	\$ 2,691,983	\$ 131,851	\$ 2,823,834
STRL	6,000	6,000	(1,933)	10,067	—	10,067
Asbestos Abatement	13,253	—	(1,420)	11,833	—	11,833
Total Long-term Debt ...	\$ 2,494,146	\$ 232,700	\$ (12,963)	\$ 2,713,883	\$ 131,851	\$ 2,845,734
Less Current Portion and Net Premium/Discount						(18,746)
Total Long-term Debt, net of Current Portion and Premium/Discount						\$ 2,826,988

NOTE 8. LONG-TERM DEBT (continued)

The Unlimited Tax General Obligation Bonds are being repaid in the Debt Service Fund from Replacement Tax revenue, revenue from an Intergovernmental Agreement with the City of Chicago and General State Aid to the extent possible, and then from a separate tax levy associated with the bonds. The future payments are scheduled as follows (\$000's):

Fiscal Year(s)	Maturities		
	Principal	Interest	Total
2003	\$ 10,765	\$ 110,040	\$ 120,805
2004	14,695	109,379	124,074
2005	15,475	108,567	124,042
2006	16,335	107,729	124,064
2007	17,170	106,830	124,000
2008-2012	285,540	596,291	881,831
2013-2017	407,366	641,378	1,048,744
2018-2022	558,032	613,514	1,171,546
2023-2027	740,496	563,535	1,304,031
2028-2032	626,109	679,953	1,306,062
Total	\$ 2,691,983	\$ 3,637,216	\$ 6,329,199

Interest rates on the bonds range from 4.0% to 6.75%, except that CPS does not pay or accrue interest on the Series 2001B Bonds, the Series 2000E Bonds, the IDFA Series 1999A Bonds and the Series 1998 Bonds. Interest and maturities include accretable interest on the Capital Appreciation Bonds as follows (\$000's):

Series	Accreted Interest June 30, 2001	Increase	Accreted Interest June 30, 2002	Total Accretable Interest	Remaining Accretable Interest
1997A	\$ 8,009	\$ 2,522	\$ 10,531	\$ 53,485	\$ 42,954
1998B-1	47,471	19,424	66,895	816,756	749,861
1999A	37,288	17,137	54,425	617,287	562,862
	\$ 92,768	\$ 39,083	\$ 131,851	\$ 1,487,528	\$ 1,355,677

The loans with the EPA to fund specific asbestos abatement projects are non-interest bearing and are being repaid over a 20-year period. No specific revenue sources are currently dedicated to provide for asbestos abatement loan retirements.

NOTE 9. CAPITALIZED LEASE OBLIGATIONS

Annual rental payments are made pursuant to lease agreements with the Public Building Commission (the "PBC"). The PBC constructs, rehabilitates and equips school buildings and facilities for use by the CPS. The annual lease rentals, funded by a tax levy, are established when the CPS approves such construction.

Annual rentals exceed the PBC's requirements for debt service and other estimated expenses. The PBC can authorize rent surpluses to be used either to reduce future rental payments or to finance construction of other CPS projects.

NOTE 9. CAPITALIZED LEASE OBLIGATIONS (continued)

The future PBC and capitalized equipment leases due at June 30, 2002, are as follows (\$000's):

<u>Fiscal Year(s)</u>	<u>PBC Lease Rentals</u>	<u>Equipment Leases</u>	<u>Total</u>
2003	\$ 133,101	\$ 2,377	\$ 135,478
2004	133,598	1,323	134,921
2005	167,906	371	168,277
2006	51,359	53	51,412
2007	51,765	6	51,771
2008-2012	259,268	—	259,268
2013-2017	259,993	—	259,993
2018-2020	134,805	—	134,805
Total rentals	\$ 1,191,795	\$ 4,130	\$ 1,195,925
Less — Interest and other costs	(405,951)	(1,000)	(406,951)
Principal amount of rentals due	<u>\$ 785,844</u>	<u>\$ 3,130</u>	<u>\$ 788,974</u>

Following is a summary of changes in PBC Leases and Capitalized Lease Obligations Outstanding (\$000's):

	<u>Balance June 30, 2001</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2002</u>
PBC Leases	\$ 849,784	\$ —	\$ (63,940)	\$ 785,844
Capitalized Lease Obligations	4,931	929	(2,730)	3,130
Total	<u>\$ 854,715</u>	<u>\$ 929</u>	<u>\$ (66,670)</u>	<u>\$ 788,974</u>
Less: Current Portion				(86,948)
Total PBC Leases and Capitalized Lease Obligations Outstanding				<u>\$ 702,026</u>

NOTE 10. OTHER LONG-TERM LIABILITIES

The following is a summary of changes to other long-term liabilities (\$000's):

	<u>Balance June 30, 2001</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance June 30, 2002</u>
Accrued Sick Pay Benefits	\$ 162,832	\$ 55,748	\$ (28,975)	\$ 189,605
Accrued Vacation Pay Benefits	19,956	29,545	(3,089)	46,412
Accrued Workers' Compensation				
Claims	27,322	18,307	(15,773)	29,856
Tort Liabilities and other claims	5,525	88,550	(71,550)	22,525
Total	<u>\$ 215,635</u>	<u>\$ 192,150</u>	<u>\$ (119,387)</u>	<u>\$ 288,398</u>
Less: Current Portion				(19,464)
Total Other Long-term Liabilities				<u>\$ 268,934</u>

Sick Pay Benefits

The CPS provides sick pay benefits for substantially all of its employees. Eligible employees can accumulate a maximum of 305 days in fiscal year 2002. If an employee either reaches age 65; is age 58

NOTE 10. OTHER LONG-TERM LIABILITIES (continued)

with between 20 and 33 years of service; has 34 years of service, or; dies, they are entitled to receive, as additional cash compensation, all or a portion of their accumulated sick leave days. The CPS budgets an amount each year in the General Operating Fund for these estimated payments to employees terminated in the current fiscal year.

Vacation Pay Benefits

For vested employees, the maximum number of accumulated unused vacation days permitted is 40 days for eligible employees with up to 10 years of service; 53 days for those with 10 to 20 years of service; and 66 days for those with more than 20 years of service. All employees are entitled to receive 100% of accumulated vacation days at their current salary rate. In fiscal year 2002, the liability for accrued vacation pay benefits was computed using the employee's actual daily wage instead of average daily wage as used in prior years.

Accrued Workers' Compensation, Tort Liabilities and Other Claims

The CPS is substantially self-insured and assumes risk of loss as follows:

The CPS maintains commercial excess property insurance for "all risks" of physical loss or damage with limits of \$150,000,000 and Boiler & Machinery Insurance with limits of \$100,000,000 with the following deductibles:

Data Processing Equipment & Media	\$ 25,000
Mechanical Breakdown	\$ 50,000
All Other Losses	\$ 500,000

During fiscal years 2002, 2001 and 2000 no settlements were made in excess of the self-insured amount.

The CPS maintains commercial excess liability insurance with limits of \$100,000,000 in excess of a \$10,000,000 self-insured retention per loss for claims arising from: General Liability; Automotive Liability; Employers Liability; and Wrongful Acts.

As discussed in Note 14, there are pending Workers' Compensation and tort claims involving the CPS which have arisen out of the ordinary conduct of business. The CPS budgets an amount each year in the Workers' and Unemployment Compensation/Tort Immunity Fund for the estimated claims and recognizes its expense as soon as the liability is incurred. As further discussed in Note 1, these expenditures are met through an annual tax levy.

The CPS' estimate of liabilities for tort and workers' compensation claims is based on reserves established by the respective trial attorneys or the claims administrators. The CPS accrues for the estimated workers' compensation and tort claims where there is a likelihood that an unfavorable outcome is probable. Expenditures are recognized for these claims as the amount accrued during the fiscal year that would normally be liquidated with expendable available financial resources. The CPS is self-insured for workers' compensation claims and certain employee health insurance costs (reimbursed to a provider on a cost plus fees basis). A liability of \$50 million has been recorded in the General Operating Fund for estimated medical claims including incurred but not reported as of June 30, 2002. Following is the activity related to medical claims for which the CPS is self-insured (\$000's):

<u>Balance</u> <u>June 30, 2000</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2001</u>	<u>Additions</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2002</u>
<u>\$ 34,994</u>	<u>\$ 130,356</u>	<u>\$ (130,305)</u>	<u>\$ 35,045</u>	<u>\$ 148,300</u>	<u>\$ (133,391)</u>	<u>\$ 49,954</u>

NOTE 11. PENSION BENEFITS

Pension benefits for certified teachers and administrators are provided under a defined benefit single employer plan administered by the Public School Teachers' Pension and Retirement Fund of Chicago (the "Pension Fund"). There are no assets of the CPS included in the Pension Fund. Copies of the Pension Fund Annual Report are available by contacting the Public School Teachers' Pension & Retirement Fund of Chicago, 55 West Wacker Drive, Chicago, Illinois 60601.

The retirement, survivor and disability benefits provided by the Pension Fund are governed by Article 17 of the Illinois Pension Code. Participation in the Pension Fund is mandatory for all members of the teaching force and employees of the Pension Fund. As of June 30, 2001, the most recent report, there were 37,648 active participants in the Pension Fund, substantially all of who were employees of the CPS.

A member of the Pension Fund with at least 20 years of service is entitled to a pension upon attainment of age 55. A member with at least 5 but less than 20 years of service is entitled to a pension upon attainment of age 62. The pension benefit is based upon years of service and salary level.

Participating members contribute 9% of salary, allocated as follows: 7.5% for retirement pension, 0.5% for automatic annual increases and 1.0% for survivor's pension. In fiscal year 2002, as in previous fiscal years, the CPS agreed to pay a portion (7% – \$103,674,000) of the required employees' contribution, which has been recorded as an expenditure in the accompanying financial statements. The funding of the 7% portion is provided by a portion of grant funds from the Federal government and General Operating Fund revenues. The remaining portion (2%) is withheld from teachers' salaries.

The CPS' employer-required contributions, with the exception of contributions from Federal funds, are not actuarially determined. State law requires statutorily determined CPS employer contributions. The CPS' employer-required contributions towards the cost of retirement benefits, and their related sources of funding, are as follows (\$000's):

Retirement benefit contribution:

An appropriation from the Illinois General Assembly	\$ 65,045
A portion of grant funds from the Federal government for teachers paid from certain Federally-funded programs	10,292
Total contributions	<u>\$ 75,337</u>

For the fiscal year ended June 30, 2002, employee contributions are \$146,528,000 which is 9% of covered payroll. Employer contributions for the year are \$75,337,000 which is approximately 5% of covered payroll.

The CPS recognizes its pension expenditures as the amount accrued during the year that normally would be liquidated with expendable available financial resources (i.e., total CPS contributions).

The government fund financial statements reflect expenditures on both a functional and account basis. Teachers' pension expenditures reflected on an account basis include both the CPS' employer share of pension expenditures of \$75,337,000 and amounts incurred by the CPS for a portion of the required employees' pension contribution of \$103,674,000, which total \$179,011,000. For functional reporting purposes, all teachers' pension expenditures, except that portion funded by the State, are reflected in the same functional classifications as the teachers' salaries.

NOTE 11. PENSION BENEFITS (continued)

The CPS' annual pension cost for fiscal years 2002, 2001 and 2000 are as follows (\$000's):

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Annual required contribution	\$ 178,855	\$ 188,923	\$ 138,441
Interest on Net Pension Obligation (NPO)	50,149	40,148	34,179
Adjustment to annual required contribution	<u>(30,865)</u>	<u>(24,710)</u>	<u>(21,036)</u>
Annual Pension Cost (APC) for the fiscal year ended June 30,			
2002	\$ 198,139	\$ 204,361	\$ 151,584
Less: Contributions made	<u>(75,337)</u>	<u>(79,347)</u>	<u>(76,972)</u>
Increase in NPO	\$ 122,802	\$ 125,014	\$ 74,612
Add NPO, beginning of year	<u>626,865</u>	<u>501,851</u>	<u>427,239</u>
NPO, end of year	<u>\$ 749,667</u>	<u>\$ 626,865</u>	<u>\$ 501,851</u>

Actuarial valuation date	June 30, 2001
Actual cost method	Projected Unit Credit Actuarial Cost Method
Amortization method	Level percent, open
Remaining amortization period	40 years
Asset valuation method	4 year smoothed market
Actuarial assumptions:	
Investment rate of return	8%
Projected salary increases	Average of 5.5% per year
Inflation	3%

The Statement of Activities reflect pension expense equal to the actuarially determined APC which have been allocated to functions/programs based on salaries and benefits.

No assets of the plan are held for post-retirement health care benefits. Pursuant to state statute, the Fund allocates amounts, which are includable as a component of APC, to fund the current year cost of post-retirement health care benefits. For the fiscal years 2001, 2000 and 1999, the Fund allocated \$40 million, \$40 million and \$25 million, respectively, of the APC for such costs.

At June 30, 2001, June 30, 2000 and June 30, 1999 (the actuarial valuation dates), the Schedule of Funding Progress and other trend information is as follows (\$000's):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Actuarial value of assets	\$ 10,392,705	\$ 9,612,203	\$ 8,620,060
Less: Actuarial Accrued Liability (AAL)	<u>(10,387,569)</u>	<u>(9,940,372)</u>	<u>(8,551,880)</u>
AAL unfunded liability (surplus)	<u>\$ (5,136)</u>	<u>\$ 328,169</u>	<u>\$ (68,180)</u>
Funded ratio	99.9%	96.7%	100.8%
Covered payroll	\$ 1,690,264	\$ 1,651,810	\$ 1,521,182
Unfunded AAL as a percentage of covered payroll	0.30%	19.87%	(4.48%)
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Annual pension cost	\$ 198,139	\$ 204,361	\$ 151,584
Percentage of annual pension cost contributed	38%	39%	50%
Net Pension Obligation	\$ 749,667	\$ 626,865	\$ 501,851

The Fund had a significant decrease in its investment portfolio during its fiscal year due to declining market conditions as a result of a softening economy. During the period from July 1, 2000 through June 30, 2001 the fair value of the Fund's investments decreased approximately \$493,516,606, or 4.9%, to

NOTE 11. PENSION BENEFITS (continued)

\$9,686,583,551. For the period July 1, 2001 through June 30, 2002 the fair value of the Fund's investments decreased approximately \$398,928,949, or 4.1%, to \$9,287,654,602.

In the opinion of the CPS' legal counsel, the unfunded actuarial liability of the Pension Fund is not a liability to be funded by the CPS; however, the CPS is required to provide funding in addition to amounts provided from Federal and State Sources if the funded ratio drops below 90%. No additional General Operating Fund appropriation was required for the fiscal year ended June 30, 2002.

OTHER PERSONNEL —

All career service employees of the CPS, except CPS employees who are members of the Public School Teachers' Pension and Retirement Fund, participate in the Municipal Employees' Annuity and Benefit Fund of Chicago (the "Annuity Fund").

Employees with at least 10 years of service who have attained 55 years of age at the time they withdraw from service must accept an annuity if they are not eligible for a refund of their annuity contribution. Employees under the age of 55 with at least 10 years of service who withdraw from service may accept a refund of their contributions plus interest or let the contributions remain in the Annuity Fund and receive an annuity, beginning upon application for an annuity, after they attain 55 years of age. If an employee withdraws from service with less than 10 years of service, accumulated annuity contributions plus interest are refunded.

Except as described below, the CPS makes no direct contributions to the Annuity Fund, which receives its income from three primary sources: a City of Chicago tax levy; income from investments; and deductions from participating employees' salaries.

Covered employees are required by Article 8, Chapter 40 of the Illinois Compiled Statutes to contribute a percentage of their salary (8.5%). In fiscal year 2002, as in previous fiscal years, the CPS agreed to pay a portion (7% – \$29,443,000) of the required employees' contribution for most employees. The CPS also receives a portion of the cost of providing pension benefits from grants by the Federal government for career service employees paid from certain Federally-funded programs. Such contributions, amounting to \$3,945,000, which are remitted to the Annuity Fund, have been recorded as revenues and expenditures in the General Operating Fund in fiscal year 2002. The amount reflected as career service pension expenditures in the accompanying governmental fund financial statements is \$70,843,000, \$29,443,000 of this amount represents the required employees' contribution paid by the CPS on behalf of its employees, and \$37,455,000 is contributed by the City of Chicago through its specific tax levies for pension plans and the remaining \$3,945,000 is funded under Federally-funded programs. The portion funded by the City of Chicago and Federal Government is also reflected as revenue in the General Operating Fund.

Career service pension expense in the government-wide financial statements is \$70,843,000.

As of December 31, 2001, the date of the latest available report, the Annuity Fund had net assets of approximately \$5,820,766,000 and an unfunded accrued actuarial liability for all covered employees, including CPS employees, of approximately \$467,000,000. The CPS employs approximately 15,000 of the 36,679 active participants in the Annuity Fund. The CPS, in the opinion of its legal counsel, has no duty to contribute any sum to the Annuity Fund.

NOTE 12. THE CHICAGO SCHOOL FINANCE AUTHORITY

In 1979, the CPS was unable to continue normal operations because of a severe cash shortage. As a result, the Chicago School Finance Authority (the "Authority") was created in January 1980 to exercise oversight and control over the financial affairs of the CPS. Additionally, the Authority issued

NOTE 12. THE CHICAGO SCHOOL FINANCE AUTHORITY (continued)

\$573,000,000 of bonds and provided the CPS with \$450,431,000 for operating purposes in fiscal years 1980 and 1981.

In 1984, the Authority issued \$114,500,000 principal amount of additional general obligation bonds to provide the CPS with money for school rehabilitation and construction purposes.

In February 1994, the Authority issued \$405,380,000 principal amount of general obligation bonds to provide the CPS with \$175,000,000 and \$203,000,000 for operating purposes for the CPS' fiscal year ending August 31, 1994 and 1995, respectively.

The amount of Authority bonds outstanding at June 30, 2002, net of bonds advance refunded or defeased is \$458,180,000. The Authority's bonds are not a direct or contingent obligation of the CPS.

The principal amount of general obligation bonds of the Authority at June 30, 2002 is shown below (\$000's).

<u>Fiscal Year(s)</u>	<u>Maturities</u>		
	<u>Principal and Sinking Fund Installments</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 66,770	\$ 24,019	\$ 90,789
2004	56,900	20,616	77,516
2005	59,710	17,805	77,515
2006	78,595	14,795	93,390
2007	62,140	10,607	72,747
2008-2009	134,065	10,969	145,034
Total	<u>\$ 458,180</u>	<u>\$ 98,811</u>	<u>\$ 556,991</u>

Interest rates on the above Authority bonds range from 4.2% to 7.6%.

The Authority is a separate body politic and corporate and a unit of local government with the power to levy property taxes. The Authority will remain in existence until one year after all bonds and notes issued by it have been discharged. The Authority had various financial oversight powers related to the CPS until June 30, 1995. Public Act 90-757 suspended the powers of the Authority until 2004.

NOTE 13. FUND BALANCE

The Fund Balance Reserved for Specific Purposes amount consists of the following (\$000's):

<u>Purpose</u>	<u>Reserved Amount</u>
Workers' Compensation/Tort Immunity	\$ 9,204
Medicare	147
Supplementary General State Aid	19,895
Public Building Commission Operations and Maintenance	6,850
Total	<u>\$ 36,096</u>

The amount reserved for Supplementary General State Aid represents the unexpended and unencumbered portion of the 2001 Supplementary General State Aid allocation.

NOTE 13. FUND BALANCE (continued)

In its fiscal year 2003 budget, CPS appropriated in its General Operating Fund \$43.7 million of fund balances from amounts reserved for specific purposes.

In its fiscal year 2002 budget, CPS designated \$345.8 million to provide working capital. In its fiscal year 2003 budget, CPS has designated \$201.5 million of June 30, 2002 fund balance to provide working capital.

During fiscal year 2002, the Board reserved \$459,524,000 for Debt Service of which \$214,454,000 was allocated to the Bond Redemption and Interest Program and the remaining \$245,070,000 was allocated to the Public Building Commission Leases Program.

NOTE 14. LITIGATION AND CONTINGENCIES

a. Pension Fund Litigation

In 1993, the Public School Teachers' Pension and Retirement Fund ("Fund") filed a lawsuit claiming that the Board failed to make certain statutorily required contributions to the Fund in the fiscal years ended August 31 of 1992, 1993 and 1994. The Fund's complaint alleges three basic claims: First, that the amounts paid to the Fund by the Board with respect to teachers working in Federal programs for which it receives Federal funds, do not count as employer contributions under the Pension Code, notwithstanding that employee contributions for such teachers do count. The amounts of money implicated in the fiscal years 1991, 1992, and 1993 were \$7,972,439, \$8,473,930 and \$10,158,343, respectively. The Fund's second claim involves employer contributions made by the Board for teachers electing early retirement. The Board contributed \$22,208,684 in August 1993 on behalf of those employees who elected early retirement that month. This contribution was paid under the lump sum plan for a number of retirees and under the installment plan (i.e., quarterly payments over a five-year period) for the remaining retirees. The Fund claims that this payment did not count as an employer contribution for purposes of the Pension Code even though the teacher contributions are deemed employee contributions. Based on this assertion, the Fund would have the Board make a "double" payment of the employer contribution. The Fund's third claim concerns the Pension Code provision which allows retired teachers to purchase constructive service credit for time spent in military service (either before becoming a teacher or after leaving the Board). The Pension Code requires retired teachers to pay all costs to the Fund for such added credit that is "an amount equal to the employer's normal cost of benefits accrued from such service plus interest." The Fund, however, contends that the payments for military service credits including the employer's normal cost of benefits are employee contributions, totaling \$1,633,476 and \$17,122 in fiscal years 1992 and 1993.

In December, 1996, the Board sought partial summary judgment determinative that the payments made to the Fund as employer contributions for teachers taking early retirement and that its payments to the Fund for teachers in Federally-assisted programs are employer contributions for purposes of the deficiency provision of the Pension Code. Further, the motion sought a determination that retired teachers' payments for military service credit should not be treated as employee contributions requiring an employer match.

On February 28, 1997, the Circuit Court of Cook County granted the Board's partial Motion for Summary Judgment in all material aspects. The court reserved for later resolution the question whether the Board would owe interest on certain employee contributions for employees retiring early for alleged late payment. No final judgment has been rendered by the court in this case as of the date hereof. The Board has undertaken settlement discussions with the Fund in order to resolve this matter.

b. Teacher Tenure

Maurice Land, et al. v. Board of Education of the City of Chicago, et al., is a lawsuit filed in 1999 against the Board in which the plaintiffs are teachers laid-off pursuant to the Board's policy on reassignment

NOTE 14. LITIGATION AND CONTINGENCIES (continued)

and layoff of regularly appointed and certified teachers. Some of the plaintiffs were those who lost their assignments during the 1997 reconstitution of seven high schools. The complaint is for mandamus, declaratory and injunctive relief. The complaint asserts violation of the School Code provision relating to tenure. The trial court granted the Board's motion for summary judgment and the Chicago Teachers Union ("CTU") sought review in the Illinois Appellate Court.

On August 27, 2001, the Appellate Court issued an opinion affirming in part and reversing in part the Circuit Court's decision. The Appellate Court concluded, among other things, that (i) the Board has the statutory power to layoff tenured teachers, including the Plaintiffs here, (ii) the Board complied with the Policy in laying off the Plaintiffs, and (iii) the layoffs did not violate Plaintiffs' due process rights. With respect to each of these issues (and others), the Appellate Court affirmed the Circuit Court's grant of summary judgment in favor of the Board. However, the Appellate Court also held that although "the Board may establish a layoff policy . . . , [the Board] may not through that policy delegate its absolute layoff power to school administrators." The Court remanded the case for further proceedings related to the delegation issue and related to the factual issues relating to the employment record of one of the Plaintiffs.

On September 17, 2001, the CPS filed a Petition for Rehearing challenging the Appellate Court's ruling on the delegation issue, which was denied on October 20, 2001. The Board intends to continue to litigate this matter vigorously and will now ask the Illinois Supreme Court to review the delegation issue.

Should the CTU ultimately prevail, the Court could order reinstatement and back wages for all of the Plaintiffs. The total amount of exposure may be significant, depending on the length of time that passes from the date of the layoff to the date of an ordered reinstatement. Given the current status of these matters, it is not possible to determine whether an ultimate finding of liability against the Board is probable or the exact cost associated with any such finding.

c. Property Tax Appeals Board (PTAB) Decisions

In March 2000 and August 2001, the PTAB rendered two series of decisions in which it granted reduced assessed valuations to the owners of certain real property by employing lower levels of assessment. In the March decisions, the PTAB elected to utilize the median levels of assessment derived from the Illinois Department of Revenue's sales-ratio studies (the "Sales-Ratio Studies") as the mechanism for determining correct assessment levels, instead of those set forth in the Cook County Real Property Assessment Classification Ordinance (the "Classification Ordinance"). Use of the Sales-Ratio Studies resulted in a lower assessment level than required by the Classification Ordinance. In its August 2001 decisions, after examining the Sales Ratio Studies, the PTAB held that the Cook County Assessor's assessment practices violated a provision of the State Constitution, which limits the level of assessment of the highest class of property, in a county that classifies property, to two and one-half times the level of assessment of the lowest class of property in that county. As a result, the PTAB established a maximum assessment level that is significantly below the assessment levels for commercial and industrial property currently set forth in the Classification Ordinance. Consistent with these opinions, the PTAB has continued to apply a lower level of assessment to certain commercial and industrial properties that have come before it on appeal and has awarded property tax refunds to such property owners.

The Board of Review, through the Cook County State's Attorney, appealed the March 2000 decisions to the Illinois Appellate Court. The Board filed an amicus brief in these cases and awaits the ruling of the Appellate Court. In September 2001, the Board of Review petitioned the Appellate Court to review the August 2001 decisions of the PTAB. The Board and other taxing jurisdictions plan to file amicus briefs in these cases.

NOTE 14. LITIGATION AND CONTINGENCIES (continued)

If either of the PTAB decisions were affirmed in a final judicial decision, the lower levels of assessments would be applied to all property tax appeals then pending before either the PTAB or before a court, resulting in corresponding property tax refunds that the Board would be obligated to pay. At present, however, the Board is unable to predict the amount of any such refunds, all of which would be funded from the Board's future general revenues.

d. State and Federal Aid Receipts

State and Federal aid is generally subject to review by the responsible governmental agencies for compliance with the agencies' regulations governing the aid. In the opinion of CPS management and legal counsel, any potential adjustments to the Federal or State aid recorded by CPS through June 30, 2002, resulting from a review by a responsible government agency will not have a material effect on CPS' financial statements at June 30, 2002.

e. Asbestos and Lead Abatement

Under Federal and State asbestos and lead abatement laws and guidelines, CPS will be required to perform significant amounts of asbestos and lead abatement in school facilities. The cost of the asbestos and lead abatement is estimated to be substantial. These future costs will be recorded as expenditures when the work is performed. Although the amount, funding and timing of the future expenditures required is uncertain, CPS intends to comply with all Federal and State asbestos and lead abatement laws and guidelines.

f. Other Litigation and Claims

There are numerous other claims and pending legal actions involving CPS, including actions concerned with civil rights of employees, workers' compensation, torts, property tax objections, and other matters, arising out of CPS' ordinary conduct of its business. Certain actions involve alleged damages in substantial amounts. The amounts of liability, if any, on these claims as of June 30, 2002, in excess of related insurance coverage with respect to certain claims, are not determinable at this time. In the opinion of CPS management and legal counsel, the final resolution of these claims and legal actions will not be material to CPS' financial statements as of June 30, 2002.

NOTE 15. SUBSEQUENT EVENTS

Unlimited Tax General Obligation Bonds (Series 2002A)

In September 2002, CPS issued \$48,970,000 in Unlimited Tax General Obligation Bonds (Series 2002A). The proceeds from these bonds are being used as part of CPS' Capital Improvement Program. As a result of the issuance, CPS recorded net proceeds of \$46,944,403 in the Capital Improvement Fund in fiscal year 2003.

Sarkissian v. Board of Education

On July 3, 2002, the Illinois Supreme Court issued a decision in *Sarkissian v. Chicago Board of Education*. The judgment slightly exceeds \$17 million and is recorded in the government-wide financial statements. On July 24, 2002, the Board filed a petition for rehearing, requesting that the Court again reconsider its decision in this case. The Board is awaiting a ruling on this petition.

Charter Schools Loans

On July 24, 2002, the CPS entered into a lease agreement with Perspectives Charter Schools whereby the Board has agreed to act as guarantor for up to \$4 million in construction loans.

APPENDIX B

SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE

The following is a summary of certain provisions of the Indenture not summarized elsewhere in this Official Statement. Reference is made to the Indenture for a complete description thereof. The discussion herein is qualified by such reference. Definitions used in this Official Statement relating to the Bonds in an Auction Rate Mode and the Auction Procedures are set forth in APPENDIX E—“AUCTION PROCEDURES.”

Definitions of Certain Terms

“*Additional Bonds*” means any Alternate Bonds issued by the Board in the future in accordance with the provisions of the Debt Reform Act on a parity with and sharing ratably and equally in all or any portion of the Pledged State Aid Revenues with the Bonds, as described in this APPENDIX B under the heading “Additional Bonds Payable from Pledged State Aid Revenues.”

“*Adjustment Date*” means (a) the Date of Issuance, (b) any date which is the first day of an Adjustment Period, (c) any Substitute Adjustment Date, and (d) any proposed Term Rate Conversion Date or Fixed Rate Conversion Date.

“*Adjustment Period*” means, with respect to each Bond, each period commencing on an Adjustment Date for such Bond to and including the day immediately preceding the immediately succeeding Adjustment Date for such Bond (or the Maturity Date thereof), during which period such Bond shall operate in one type of Interest Mode.

“*Alternate Bonds*” means general obligation bonds payable from any revenue source as provided by the Debt Reform Act, particularly Section 15 thereof.

“*Auction Rate Documents*” means any Auction Agent Agreement, Broker-Dealer Agreement or other agreement required to be executed and delivered at any time in order to effectuate the Auction Procedures in connection with any Auction Rate Mode designated by the Board hereunder.

“*Auction Rate Mode*” means an Interest Mode during which the rate of interest borne by the Bonds is determined as described in APPENDIX E—“AUCTION PROCEDURES.”

“*Authorized Denominations*” means, (i) with respect to a particular Bond in a Short Mode, \$100,000 and any multiple of \$5,000 in excess thereof, (ii) with respect to a particular Bond in a Term Rate Mode, \$5,000 and any integral multiple thereof, (iii) with respect to a particular Bond in an Auction Rate Mode, \$25,000 and any integral multiple thereof, and (iv) after the Fixed Rate Conversion Date with respect to a particular Bond, \$5,000 and any integral multiple thereof.

“*Authorized Officer*” means (i) any Designated Official; (ii) the Controller and Chief Operating Officer of the Board acting together; or (iii) any other officer or employee of the Board authorized to perform specific acts or duties hereunder by resolution duly adopted by the Board.

“*Bank*” means any provider then obligated under a Liquidity Facility delivered in accordance with the terms of the Indenture. As of the date of issuance of the Bonds, there is no Bank.

“*Bank Approval*” means the written approval of the Bank, if such approval is required pursuant to the then-applicable Liquidity Agreement.

“Bank Bonds” means Tendered Bonds purchased with moneys drawn under the Liquidity Facility pursuant to the Indenture, which are owned by the Bank or its permitted assigns in accordance with the Liquidity Agreement or the Custody Agreement, if any, until such Bonds are remarketed by the Remarketing Agent pursuant to the Remarketing Agreement or such Bonds lose their characterization as Bank Bonds pursuant to the Liquidity Agreement.

“Bank Obligations” means the Board’s obligations under the Liquidity Agreement.

“Bank Rate” means with respect to any Bank Bond, such interest rate or sequence of rates (which may be stated as a formula and may be determined by reference to a specified index or indices) as is specified in the Liquidity Agreement then in effect pursuant to which such Bank Bond was purchased. Notwithstanding the foregoing, at no time shall the Bank Rate be higher than the Maximum Interest Rate.

“Board” means the Board of Education of the City of Chicago, as governed by the Chicago Board of Education, created and established pursuant to Article 34 of the School Code.

“Bond Counsel” means any nationally recognized firm(s) of municipal bond attorneys approved by the Board and acceptable to the Trustee.

“Bondholder” means the Owner of any Bond.

“Bond Insurance Policy” means the Initial Bond Insurance Policy to be delivered by the Initial Bond Insurer to the Trustee on the Date of Issuance, unless and until such Bond Insurance Policy is canceled pursuant to the Indenture, and thereafter *“Bond Insurance Policy”* means any Substitute Bond Insurance Policy delivered by a Substitute Bond Insurer and accepted by the Trustee in substitution therefor pursuant to the Indenture.

“Bond Insurance Substitution Date” means the day on which a Substitute Bond Insurance Policy becomes effective.

“Bond Insurer” means the Initial Bond Insurer, as issuer of the Initial Bond Insurance Policy, until such Bond Insurance Policy is canceled pursuant to the Indenture, and thereafter *“Bond Insurer”* means a Substitute Bond Insurer as the obligor on any Substitute Bond Insurance Policy accepted by the Trustee in substitution therefor pursuant to the Indenture.

“Bond Insurer Approval” means the written approval of the Bond Insurer, if such approval is required pursuant to the Indenture or the then-applicable Insurance Agreement.

“Bond Insurer Obligations” means the Board’s obligations to the Bond Insurer pursuant to the Indenture or in connection with the Bond Insurance Policy or any applicable Insurance Agreement.

“Bond Payment Account” means the Bond Payment Account established in the Indenture.

“Bond Purchase Fund” means the trust fund so designated which is created and established pursuant to the Indenture.

“Bond Resolution” means, Resolution No. 03-1119-RS12, adopted by the Board on the 19th day of November, 2003, authorizing the issuance of the Bonds.

“Bond Year” means each annual period beginning on March 2 of a calendar year to and including March 1 of the next succeeding calendar year.

“*Bonds*” means, collectively, the \$257,925,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D of the Board, being initially issued under the Indenture in four Subseries, as follows: the \$50,025,000 Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-1, the \$65,000,000 Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-2, the \$71,450,000 Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-3, and the \$71,450,000 Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-4, being issued under the Indenture and any Bonds issued hereunder in substitution or replacement therefor, and includes any Bank Bonds from time to time Outstanding.

“*Business Day*” means any day other than a Saturday, Sunday or (i) a day on which banks located (a) in the city in which the principal corporate trust office of the Trustee is located, (b) in the city in which the office of the Bond Insurer or the Bond Insurer’s custodian at which claims under the Bond Insurance Policy are to be paid (initially, New York, New York) is located, (c) in the city in which the principal United States office of the Bank at which drawings under the Liquidity Agreement are to be honored is located, (d) in the city in which the corporate trust office of the Trustee or the Trustee’s Agent at which the Bonds may be tendered for purchase by the holders thereof is located, (e) in the city in which the principal office of the Auction Agent is located and (f) in the city in which the principal office of the Remarketing Agent is located, are required or authorized to remain closed or (ii) a day on which The New York Stock Exchange is closed.

“*Code*” or “*Code and Regulations*” means the Internal Revenue Code of 1986, as amended, and the regulations promulgated or proposed pursuant thereto as the same may be in effect from time to time.

“*Counsel’s Opinion*” or “*Opinion of Counsel*” means an opinion signed by an attorney or firm of attorneys of recognized standing in the area of law to which the opinion relates, who may be counsel to the Board (including the internal Counsel to the Board) or Bond Counsel.

“*County Clerks*” means, collectively, the County Clerks of The Counties of Cook and DuPage, Illinois.

“*County Collectors*” means, collectively, the County Treasurers of The Counties of Cook and DuPage, Illinois, in their respective capacities as county collector, or, respectively, such other officer as may be lawfully appointed in the future to serve as county collector in either of said counties.

“*Custody Agreement*” means a custody agreement or a pledge and security agreement (which may also be the Liquidity Agreement), if any, entered into by the Trustee, as custodian, and the Bank, and any and all amendments and supplements thereto, relating to Bank Bonds.

“*Date of Issuance*” means the date of original issuance and delivery of the Bonds hereunder.

“*Debt Reform Act*” means the Local Government Debt Reform Act of the State, as amended.

“*Defaulted Interest*” means interest on any Bond which is payable but not duly paid on the date due.

“*Defeasance Government Obligations*” means Government Obligations which are not subject to redemption other than at the option of the holder thereof.

“*Defeasance Obligations*” means (i) Defeasance Government Obligations and (ii) Pre-refunded Municipal Obligations.

“*Delivery Office*” means for the Remarketing Agent, such address as shall be specified in any Remarketing Agreement delivered pursuant to the Indenture.

“*Deposit Date*” means February 15 of each year beginning February 15, 2005 or such earlier date as may be necessary to permit the Board to lawfully make the abatement of taxes described under the heading “SECURITY FOR THE BONDS—Application of Pledged State Aid Revenues; Abatement of Pledged Taxes.”

“*Deposit Sub-Account*” means the sub-account of that name in the Pledged State Aid Revenues Account established in the Indenture.

“*Designated Official*” means (i) the President of the Board; (ii) the Chief Financial Officer of the Board or (iii) any other officer of the Board authorized to perform specific acts and duties hereunder by resolution duly adopted by the Board.

“*DTC*” means The Depository Trust Company, New York, New York, as the initial Securities Depository for the Bonds.

“*Event of Default*” means any event so designated and specified as described in this APPENDIX B under the heading “Events of Defaults and Remedies—Events of Default.”

“*Fiduciary*” or “*Fiduciaries*” means the Trustee, the Registrar and any Paying Agent, or any or all of them, as may be appropriate.

“*Financing Documents*” means the Indenture, the Remarketing Agreement and the Auction Rate Documents.

“*Fitch*” means Fitch Ratings, its successors and assigns, and, if Fitch shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, “Fitch” shall be deemed to refer to any other nationally recognized securities rating agency designated by the Board by notice to the Trustee.

“*Fixed Mode*” means the Adjustment Period commencing on the Fixed Rate Conversion Date for a Bond and ending on the Maturity Date thereof, as established pursuant to the Indenture, during which the Bonds which bear interest during such Adjustment Period bear interest at the Fixed Rate.

“*Fixed Rate*” means, for the Fixed Mode applicable to a Bond, a fixed per annum interest rate borne by such Bond established pursuant to the Indenture equal to the lowest interest rate which, in the judgment of the Remarketing Agent, would enable such Bond to be remarketed at the principal amount thereof on the Fixed Rate Conversion Date for such Fixed Mode.

“*Fixed Rate Conversion*” means the conversion of the interest rate to be borne by all or any portion of the Bonds to a Fixed Rate pursuant to the Indenture.

“*Fixed Rate Conversion Date*” means an Adjustment Date for any Bond on which it begins to bear interest at a Fixed Rate.

“*Flexible Mode*” means any Adjustment Period during which the Rate Determination Date and the Rate Change Date for each Rate Period therein (which shall have a duration which is not less than 30 days (or such duration as short as two days as may be approved by the Board by written notice to the Trustee and the Remarketing Agent) nor more than 366 days) shall occur on the first day of such Rate Period which shall be designated by the Remarketing Agent pursuant to the Indenture, and during which

the Bonds which bear interest during such Adjustment Period bear interest at the Flexible Rate; provided that the Rate Determination Date and the Rate Change Date for each Rate Period within any such Adjustment Period shall not have a duration of more than 90 days without Bond Insurer Approval.

“Flexible Rate” means, for each Rate Period within a Flexible Mode applicable to a Bond, a fixed per annum interest rate borne by such Bond established pursuant to the Indenture equal to the lowest interest rate which, in the judgment of the Remarketing Agent, would enable such Bond to be remarketed at the principal amount thereof on the Rate Change Date for such Rate Period.

“Forward Supply Contract” means any contract entered into between the Board and a supplier of Investment Securities selected by or pursuant to the direction of the Board (a “Counterparty”) pursuant to which the Counterparty agrees to sell to the Board (or to the Trustee on behalf of the Board) and the Board (or the Trustee on behalf of the Board) agrees to purchase specified Investment Securities on specific dates at specific purchase prices, all as established at the time of the execution and delivery of such contract and as set forth in such contract. Any amounts due and owing from the Board to the Counterparty pursuant to any Forward Supply Contract (other than the specified purchase prices of the Investment Securities set forth therein) shall be treated as current operating expenses of the Board subject to annual appropriation, and shall not constitute indebtedness of the Board.

“Government Obligations” means (i) any direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of America and (ii) certificates of ownership of the principal of or interest on obligations of the type described in clause (i) of this definition, (a) which obligations are held in trust by a commercial bank which is a member of the Federal Reserve System in the capacity of a custodian; (b) the owner of which certificate is the real party in interest and has the right to proceed directly and individually against the obligor of the underlying obligations; and (c) for which the underlying obligations are held in safekeeping in a special account, segregated from the custodian’s general assets, and are not available to satisfy any claim of the custodian, any person claiming through the custodian, or any person to whom the custodian may be obligated.

“Immediate Notice” means notice by telephone, telex or telecopier to such address as the addressee shall have directed in writing, promptly followed by written notice by first class mail, postage prepaid; provided, however, that if any person required to give an Immediate Notice shall not have been provided with the necessary information as to the telephone, telex or telecopier number of an addressee, Immediate Notice means written notice by first class mail, postage prepaid.

“Indenture” means the Trust Indenture, dated as of December 1, 2003, by and between the Board and the Trustee, as from time to time amended and supplemented.

“Initial ARS Rate” means with respect to each Subseries of Bonds, the interest rate for the Initial Interest Period.

“Initial Auction Dates” means (i) with respect to the Series 2003D-1 Bonds, December 23, 2003, (ii) with respect to the Series 2003D-2 Bonds, January 22, 2004, (iii) with respect to the Series 2003D-3 Bonds, February 5, 2004, and (iv) with respect to the Series 2003D-4 Bonds, December 23, 2003.

“Initial Board Funds” means the funds of the Board deposited on the Date of Issuance and applied as described under the heading “THE BONDS—Estimated Sources and Uses of Funds.”

“Initial Bond Insurance Policy” means, collectively, the insurance policies issued by the Initial Bond Insurer guaranteeing the scheduled payment when due of principal of and interest on the Series 2003D-2 Bonds, the Series 2003D-3 Bonds and Series 2003-4 Bonds.

“Initial Bond Insurer” means XL Capital Assurance Inc., or any successor thereto or assignee thereof.

“Initial Interest Payment Date” with respect to each subseries of Bonds, means the day next succeeding the last day of the respective Initial Interest Period, or if any such date is not a Business Day, the next succeeding Business Day (but only for interest accrued through the last day of such Initial Interest Period next proceeding such Initial Interest Payment Date).

“Initial Interest Period” with respect to each subseries of the Bonds, means the period from and including the date of original delivery of the Bonds to and including the respective Initial Auction Date.

“Initial Swap Agreements” means, collectively, (i) the ISDA Master Agreement, the Schedule thereto and the Credit Support Annex to such Schedule, each dated as of December 3, 2003, and the related Confirmation, between the Board and Lehman Brothers Special Financing Inc., and (ii) the ISDA Master Agreement, the Schedule thereto and the Credit Support Annex to such Schedule, each dated as of February 4, 2003, as amended by the First Amendment to ISDA Master Agreements dated as of December 3, 2003, and the related Confirmation between the Board and Goldman Sachs Capital Markets, L.P.

“Initial Swap Providers” means, collectively, Lehman Brothers Special Financing Inc. and Lehman Brothers Inc. as guarantor, and Goldman Sachs Capital Markets, L.P. and Goldman Sachs Group Inc. as guarantor, and their respective successors and assigns, as counterparties to the Initial Swap Agreements.

“Insolvency Proceeding” means the filing of a petition in bankruptcy or the commencement of a proceeding under the United States Bankruptcy Code or any other applicable law concerning insolvency, reorganization or bankruptcy by or against the Board as debtor, other than any involuntary proceeding that has been finally dismissed without entry of an order for relief or similar order and as to which all appeal periods have expired.

“Insurance Agreement” means any agreement between the Board and a Bond Insurer, executed and delivered from time to time, relating to the Board’s obligations to a Bond Insurer, including initially, the Reimbursement and Indemnity Agreement dated December 1, 2003, between the Board and the Initial Bond Insurer.

“Insured Bonds” means the Series 2003D-2 Bonds, the Series 2003D-3 Bonds and the Series 2003D-4 Bonds. The Series 2003D-1 Bonds are not Insured Bonds.

“Interest Coverage Rate” means the rate used in the Liquidity Facility to calculate the maximum amount (as reduced and restated from time to time in accordance with the terms thereof) which is available for the payment of the portion of the purchase price of Tendered Bonds corresponding to interest accrued on the Tendered Bonds.

“Interest Deposit Sub-Account” means the sub-account of that name in the Payment Sub-Account of the Pledged State Aid Revenues Account established in the Indenture.

“Interest Mode” means a period of time relating to the frequency with which the interest rate on the Bonds is determined pursuant to the Indenture. An Interest Mode may be a Weekly Mode, a Flexible Mode, a Term Rate Mode an Auction Rate Mode or a Fixed Mode.

“Interest Payment Date” means each Initial Interest Payment Date and, thereafter, (a) for each Bond, each Adjustment Date therefor, (b) for any Bond in the Weekly Mode, the first Business Day of

each calendar month, (c) for any Bond in a Flexible Mode, each Rate Change Date therefor, (d) for any Bond in the Term Rate Mode, each Stated Interest Payment Date occurring in such Rate Period (beginning with the first Stated Interest Payment Date that occurs no earlier than 6 months after the commencement of such Rate Period), (e) for any Bond in a Fixed Mode, each September 1 and March 1, commencing as provided in the Indenture, (f) for any Bank Bond, such dates as are specified in the Liquidity Agreement, (g) during an ARS Rate Period, (i) when used with respect to any Auction Period other than a Special Auction Period, the Business Day immediately following such Auction Period, and (ii) when used with respect to a Special Auction Period of (x) seven or more but fewer than 92 days, the Business Day immediately following such Special Auction Period, of (y) 92 or more days, such day of the week designated by the Broker-Dealer of each thirteenth week after the first day of such Special Auction Period or the next Business Day if such day of the week is not a Business Day and on the Business Day immediately following such Special Auction Period and (h) for each Bond, the Maturity Date thereof; provided that, except with respect to (i) Bonds in the Flexible Mode (without the approval of the Board described in the definition of such term) or (ii) any Interest Payment Dates with respect to remarketed Bank Bonds under (f), in no event shall more than one Interest Payment Date for the Bonds occur in any one calendar month.

“Interest Sub-Account” means the sub-account of that name in the Bond Payment Account established in the Indenture.

“Investment Policy” means the Investment Policy approved by the Board, as currently in effect and as may be amended from time to time.

“Investment Securities” means any of the following securities authorized by law and the Investment Policy as permitted investments of Board funds at the time of purchase thereof:

- (i) Government Obligations;
- (ii) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America, including:
 - Export-Import Bank
 - Farm Credit System Financial Assistance Corporation
 - Farmers Home Administration
 - General Services Administration
 - U.S. Maritime Administration
 - Small Business Administration
 - Government National Mortgage Association (GNMA)
 - U.S. Department of Housing & Urban Development (PHA’s)
 - Federal Housing Administration;
- (iii) Senior debt obligations which at the time of purchase are rated “AAA” by Standard & Poor’s Ratings Services (“S&P”) and “Aaa” by Moody’s Investors Service, Inc. (“Moody’s”) issued by the Fannie Mae or the Federal Home Loan Mortgage Corporation, senior debt obligations of other government agencies;
- (iv) U.S. dollar denominated deposit accounts, federal funds and banker’s acceptances with domestic commercial banks which have a rating on their short term certificates of deposit on the date of purchase of “A-1” or “A-1+” by S&P and “P-1” by Moody’s and maturing no more than 360 days after the date of purchase. (Ratings on holding companies are not considered as the rating of the bank);

(v) Commercial paper which is rated at the time of purchase no less than “A-1” or above by S&P and “P-1” by Moody’s and which matures not more than 180 days after the date of purchase;

(vi) Investments in a money market fund which at the time of purchase is rated “AAAm” or “AAAm-G” or better by S&P, including those of the Trustee;

(vii) Repurchase agreements of government securities having the meaning set out in the Government Securities Act of 1986 subject to the provisions of said Act and the Regulations issued thereunder. The government securities that are the subject of such repurchase agreements, unless registered or inscribed in the name of the Board, shall be purchased through banks or trust companies authorized to do business in the State of Illinois;

(viii) Pre-refunded Municipal Obligations; and

(ix) Forward Supply Contracts.

“*Liquidity Agreement*” means any agreement then governing the Liquidity Facility, including a Substitute Liquidity Agreement, as it may from time to time be amended or supplemented, provided that the form of any such agreement shall be subject to Bond Insurer Approval, which Approval shall not be unreasonably withheld.

“*Liquidity Agreement Default*” means each “default” or “event of default,” if any, under a Liquidity Facility, the consequence of notice of which is that the Bonds shall be subject to mandatory tender pursuant to the Indenture.

“*Liquidity Facility*” means the obligation of the Bank to provide funds for the purpose of purchasing Tendered Bonds, which Liquidity Facility may be in the form of a line of credit, bond purchase agreement or letter of credit, and includes any Substitute Liquidity Facility that may be delivered pursuant to the Indenture.

“*Liquidity Substitution Date*” means the day on which a Substitute Liquidity Facility becomes effective.

“*Maturity Date*” means, (i) with respect to the Series 2003D-1 Bonds, March 1, 2014, (ii) with respect to the Series 2003D-2 Bonds, March 1, 2022, (iii) with respect to the Series 2003D-3 Bonds, March 1, 2034; and (iv) with respect to the Series 2003D-4 Bonds, March 1, 2034.

“*Maximum Interest Rate*” means, with respect to any of the Bonds at any time, the lesser of (i) the Statutory Maximum Rate, (ii) while the Bonds are in a Short Mode, the applicable Interest Coverage Rate or (iii) 15%.

“*Moody’s*” means Moody’s Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, “Moody’s” shall be deemed to refer to any other nationally recognized securities rating agency designated by the Board by notice to the Trustee.

“*Opinion of Bond Counsel*” means a written opinion of Bond Counsel in form and substance acceptable to the Board and the Trustee, which opinion may be based on a ruling or rulings of the Internal Revenue Service.

“*Outstanding*” means, as of any date, all Bonds theretofore or thereupon being authenticated and delivered under the Indenture except:

- (i) Any Bonds cancelled by the Trustee at or prior to such date;
- (ii) Bonds (or portions of Bonds) for the payment or redemption of which moneys and/or Defeasance Obligations, equal to the principal amount or Redemption Price thereof, as the case may be, with interest to the date of maturity or date fixed for redemption, are held in trust under the Indenture and set aside for such payment or redemption (whether at or prior to the maturity or redemption date), provided that if such Bonds (or portions of Bonds) are to be redeemed, notice of such redemption will have been given as provided in the Indenture or provision satisfactory to the Trustee will have been made for the giving of such notice;
- (iii) Bonds in lieu of or in substitution for which other Bonds will have been authenticated and delivered in connection with any substitution, transfer or exchange; and
- (iv) Bonds deemed to have been paid as described in this APPENDIX B under the heading “Defeasance.”

“*Owner*” means any person who shall be the registered owner of any Bond or Bonds.

“*Participant*,” when used with respect to any Securities Depository, means any participant of such Securities Depository.

“*Paying Agent*” means the Trustee and any other bank, national banking association or trust company designated by the Board or the Trustee pursuant to the Indenture as a paying agent for the Bonds, and any successor or successors appointed by a Designated Official or the Trustee under the Indenture.

“*Payment Sub-Account*” means the sub-account of that name in the Pledged State Aid Revenues Account established in the Indenture.

“*Person*” means and includes an association, unincorporated organization, a corporation, a partnership, a joint venture, a business trust, or a government or an agency or a political subdivision thereof, or any other public or private entity, or a natural person.

“*Pledged State Aid Revenues*” means that amount of the State Aid payments to be made to the Board in any year pursuant to Article 18 of the School Code, or such successor or replacement fund or act as may be enacted in the future, not in excess of \$75,000,000 in any year, as shall provide for the payment of the Bonds, any Swap Payments, and the provision of not less than an additional .25 times debt service on the Bonds, in such year.

“*Pledged State Aid Revenues Account*” means the account of that name in the Debt Service Fund established in the Indenture.

“*Pledged State Aid Revenues Account Requirement*” means:

- (i) on each Deposit Date, with respect to the Bonds bearing interest at a Short Rate or an ARS Rate, an amount equal to the sum of (A) one year’s interest on such Bonds based upon the aggregate principal amount of such Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and an interest rate equal to the greater of (x) 5.0% or (y) the actual

weighted average interest rate borne by such Bonds for the 12-month period ending on the preceding February 1; provided that such amount shall be increased or decreased, as appropriate, giving effect to the known interest to accrue with respect to any Bonds in the Flexible Mode or the Auction Rate Mode on such Deposit Date from the first day of the next succeeding Bond Year to the Interest Payment Date for such Bonds; provided, however, that for any period of time during the next succeeding Bond Year for which a Swap Agreement is in place with respect to any Bonds requiring the Board to pay a fixed rate of interest, such amount shall be increased or decreased, as appropriate, giving effect to the known fixed rate of interest to accrue with respect to such Swap Agreement for such period of time during the next succeeding Bond Year that such Swap Agreement shall be in effect, (B) if no Swap Agreement is in place, the known interest to accrue with respect to any Bonds in the Flexible Mode or the Auction Rate Mode on such Deposit Date for which the Interest Payment Date occurs in the next succeeding Bond Year from the first day of the Rate Period for such Bonds to the last day of the then-current Bond Year, and (C) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year;

(ii) on each Deposit Date, with respect to Bonds bearing interest at a Term Rate or Fixed Rate, an amount equal to the sum of (A) one year's interest on such Bonds based upon the aggregate principal amount of Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and the actual Term Rate or Fixed Rate or Term Rates or Fixed Rates then borne by such Bonds; provided, however, that for any period of time during the next succeeding Bond Year for which a Swap Agreement is in place with respect to any Bonds requiring the Board to pay a variable rate of interest, such amount shall be increased or decreased, as appropriate, by calculating interest with respect to such Bonds pursuant to subparagraph (i)(A) above, treating the Swap Agreement as the Bonds for purposes of subclause (y), above, and (B) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year; and

(iii) on each Deposit Date, with respect to any Bank Bonds, an amount equal to the sum of (A) one year's interest on such Bank Bonds based upon the aggregate principal amount of such Bank Bonds scheduled to be Outstanding on the first day of the next succeeding Bond Year and an assumed interest rate equal to the greater of (i) 8.0% or (ii) the average Bank Rate for the 12-month period ending on the preceding February 1 (regardless of whether Bank Bonds are Outstanding during such period) and (B) the principal amount of such Bonds scheduled to become due at maturity or by mandatory sinking fund redemption on the last day of the next succeeding Bond Year.

"Pledged State Aid Revenues Sub-Account" means the sub-account of that name in the Payment Sub-Account of the Pledged State Aid Revenues Account.

"Pledged Taxes" means the ad valorem taxes levied or to be levied pursuant to the covenant contained in the Indenture against all of the taxable property in the School District without limitation as to rate or amount, and pledged under the Indenture.

"Pledged Taxes Account" means the account of that name in the Debt Service Fund established in the Indenture.

"Pre-refunded Municipal Obligations" means any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and

(A) which are rated, based on an irrevocable escrow account or fund (the “escrow”), in the highest rating category of S&P and Moody’s or any successors thereto; or

(B) (i) which are fully secured as to principal and interest and redemption premium, if any, by an escrow consisting only of cash or Government Obligations, which escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (ii) which escrow is sufficient, as verified by a nationally recognized independent certified public accountant, to pay principal of and interest and redemption premium, if any, on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate.

“*Principal Sub-Account*” means the sub-account of that name in the Bond Payment Account established in the Indenture.

“*Program Expense Fund*” means the Program Expense Fund established in the Indenture and in which the Board may, at its option, deposit funds to be used to pay the ongoing fees of the Auction Agent and the Broker Dealers.

“*Project*” means the construction, acquisition and equipping of school and administrative buildings, site improvements and other real and personal property in and for the School District, all in accordance with the estimate of cost, including the Board’s Five-Year Capital Improvement Program, as heretofore approved and from time to time amended by the Board.

“*Project Costs*” means the cost of acquisition, construction and equipping of the Project, including the cost of acquisition of all land, rights of way, property, rights, easements and interests, acquired by the Board for such construction, the cost of demolishing or removing any buildings or structures on land so acquired, including the cost of acquiring any lands to which such buildings or structures may be moved, the cost of all machinery and equipment determined to be necessary and desirable by the Board, the costs of issuance of the Bonds, financing charges, financial advisory fees, consultant fees, interest prior to and during construction and for such period after completion of construction as the Board shall determine, the cost of engineering and legal expenses, plans, specifications, estimates of cost and revenues, other expenses necessary or incident to determining the feasibility or practicability of constructing any portion of the Project, administrative expenses and such other costs, expenses and funding as may be necessary or incident to the construction of the Project, the financing of such construction and the placing of the Project in operation.

“*Project Fund*” means the Project Fund established in the Indenture.

“*Rate Change Date*” means for each Rate Period (a) during any Weekly Mode, Thursday or such other day of the week designated as such by the Remarketing Agent from time to time, in accordance with the provisions of the Indenture, (b) during any Flexible Mode, the Business Day(s) specified in the notice delivered to the Trustee in accordance with the Indenture, (c) during any Term Rate Mode, the Business Day(s) specified in the notice delivered to the Trustee in accordance with the Indenture, (d) during any Auction Rate Mode, as provided in APPENDIX E and (e) each Adjustment Date.

“*Rate Determination Date*” means for (a) each Rate Period during any Weekly Mode, Wednesday or such other day of the week designated as such by the Remarketing Agent from time to time, in accordance with the provisions of the Indenture, next preceding the Rate Change Date for such Rate Period (unless such day is not a Business Day, in which case the Rate Determination Date shall be the immediately preceding Business Day), (b) each Rate Period during any Flexible Mode, the Rate Change

Date for such Rate Period specified in the notice delivered to the Trustee in accordance with the Indenture, (c) each Rate Period during a Term Rate Mode, a Business Day no earlier than thirty (30) Business Days and no later than the Business Day next preceding the first day of a Rate Period, as determined by the Remarketing Agent, (d) the Rate Period during a Fixed Mode, the date of the firm underwriting or purchase contract referred to in the Indenture, (e) the Rate Period following a proposed Fixed Rate Conversion Date in the event of a failed conversion, such proposed Fixed Rate Conversion Date, (f) for each Auction Period during any Auction Rate Mode, as provided in APPENDIX E, and (g) the Rate Period following a failed Interest Mode conversion pursuant to the Indenture, the proposed Adjustment Date.

“Rate Period” means, with respect to each Bond, each period commencing on a Rate Change Date for such Bond to and including the day immediately preceding the immediately succeeding Rate Change Date for such Bond (or the Maturity Date or date of redemption thereof), during which period such Bond shall bear interest at one specific interest rate.

“Rating Services” means the nationally recognized rating services, or any of them, that shall have assigned ratings to any Bonds Outstanding as requested by or on behalf of the Board, and which ratings are then currently in effect.

“Record Date” means (a) with respect to any Bond during a Short Mode, the Business Day immediately preceding each Interest Payment Date for such Bond, (b) with respect to any Bond during an Auction Rate Mode, the second Business Day preceding an Interest Payment Date for such Adjustment Period (c) with respect to Bonds in a Term Rate Mode, the fifteenth (15th) day (whether or not a Business Day) of the month next preceding each Interest Payment Date, and (d) with respect to any Bond during a Fixed Mode, February 15 and August 15 (whether or not a Business Day); provided, however, that if the Fixed Rate Conversion Date shall occur on or after February 15 but prior to March 1, or on or after August 15 but prior to September 1, the Record Date shall be the Fixed Rate Conversion Date.

“Redemption Price” means, with respect to any Bond, the principal amount thereof plus the applicable premium, if any, payable upon the date fixed for redemption.

“Registrar” means the Trustee and any other bank, national banking association or trust company appointed by a Designated Official under the Indenture and designated as registrar for the Bonds, and its successor or successors.

“Remarketing Agent” means the placement or remarketing agent at the time serving as such under the Remarketing Agreement and designated by the Board as the Remarketing Agent for purposes of the Indenture.

“Remarketing Agreement” means any Remarketing Agreement between the Board and a Remarketing Agent delivered under the Indenture, as the same may be amended, supplemented or assigned from time to time, or any similar agreement as may be substituted therefor.

“School Code” means the School Code of the State of Illinois, as amended.

“School District” means the school district constituted by the City of Chicago pursuant to Article 34 of the School Code, and governed by the Chicago Board of Education.

“Series 2002A Bonds” means the Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2002A of the Board.

“*Series 2002A Indenture*” means the Trust Indenture, dated as of September 1, 2002, between the Board and Cole Taylor bank, Chicago, Illinois, as trustee, providing for the issuance of the Series 2002A Bonds.

“*Series 2003B Bonds*” means the \$188,775,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003B of the Board.

“*Series 2003D-1 Bonds*” means the \$50,025,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-1, being issued under the Indenture.

“*Series 2003D-2 Bonds*” means the \$65,000,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-2, being issued under the Indenture.

“*Series 2003D-3 Bonds*” means the \$71,450,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-3, being issued under the Indenture.

“*Series 2003D-4 Bonds*” means the \$71,450,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D-4, being issued under the Indenture.

“*Short Mode*” means a Flexible Mode or a Weekly Mode.

“*Short Rate*” means a Flexible Rate or a Weekly Rate.

“*SLG’s*” means United States Treasury Certificates of Indebtedness, Notes and Bonds — State and Local Government Series.

“*Special Record Date*” means the date fixed by the Trustee pursuant to the Indenture for the payment of Defaulted Interest.

“*S&P*” means Standard & Poor’s, a Division of The McGraw-Hill Companies, Inc., its successors and assigns, and, if S&P shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, “*S&P*” shall be deemed to refer to any other nationally recognized securities rating agency designated by the Board by notice to the Trustee.

“*State*” means the State of Illinois.

“*Stated Interest Payment Dates*” means each March 1, and/or September 1.

“*Statutory Maximum Rate*” means the maximum rate of interest permitted for the Bonds from time to time pursuant to applicable law, including the Bond Authorization Act of the State, as amended.

“*Subseries*” or “*subseries*” means, in connection with the issuance of the Bonds as multiple subseries, each Subseries of the Bonds bearing a distinct numerical designation (e.g. “Series 2003D-1” or “Series 2003D-2”).

“*Substitute Adjustment Date*” means any Business Day during any Adjustment Period for Bank Bonds designated by the Board in accordance with the Indenture as the first day of a new Adjustment Period.

“*Substitute Bank*” means one or more commercial banks, trust companies or financial institutions obligated under any Substitute Liquidity Agreement selected by the Board.

“Substitute Bond Insurance Policy” means a policy (including endorsements) containing terms which are in all material respects the same as or equivalent to those provided by the Initial Bond Insurance Policy, which insures the payment of the principal of and interest on the Bonds when due and acceptable to the Bank and the Board.

“Substitute Bond Insurer” means an insurance company or financial institution obligated on any Substitute Bond Insurance Policy and acceptable to the Bank and the Board, and its successors and assigns and any surviving, resulting and transferee corporation.

“Substitute Liquidity Agreement” means any agreement (other than the Liquidity Agreement then in place) between the Board and any Substitute Bank pursuant to which a Substitute Liquidity Facility shall be in effect, as it may from time to time be amended and supplemented.

“Substitute Liquidity Facility” means a Liquidity Facility provided by a Substitute Bank other than the Bank providing the Liquidity Facility on or prior to the Liquidity Substitution Date; provided, however, that none of the following shall be deemed a Substitute Liquidity Facility: a change in the Liquidity Agreement pursuant to which the Liquidity Facility is issued; a change in the number of days of interest or interest rate covered by the Liquidity Facility; and a renewal of the term of the existing Liquidity Facility.

“Supplemental Indenture” means any Supplemental Indenture between the Board and the Trustee authorized as described in this APPENDIX B under the caption “Supplemental Indentures.”

“Swap Agreements” means the Initial Swap Agreements and any other agreement authorized under the Bond Resolution between the Board and a counterparty, the purpose of which is to provide to the Board an interest rate basis, cash flow basis or other basis from that provided in the Bonds for the payment of interest, provided that the stated notional amount under all such Swap Agreements shall not in the aggregate exceed the then outstanding principal amount of the Bonds and provided further that (i) each Rating Service (if such Rating Service also rates the unsecured obligations of the proposed Swap Provider or any person who guarantees the obligations of the Swap Provider under the Swap Agreement) has assigned the unsecured obligations of the Swap Provider or such guarantor, as of the date the Swap Agreement is entered into, a rating that is equal or higher than the rating then assigned to the Outstanding Bonds by such Rating Service (without regard to any Bond Insurance Policy or any Liquidity Facility), and (ii) the Board has notified each Rating Service (whether or not such Rating Service also rates the unsecured obligations of the Swap Provider or its guarantor, if any, under the Swap Agreement) in writing, at least 15 days prior to executing and delivering the Swap Agreement of its intention to enter into the Swap Agreement and has received from such Rating Service a written indication that the entering into the Swap Agreement by the Board will not in and of itself cause a reduction or withdrawal by such Rating Service of its unenhanced rating on the Outstanding Bonds.

“Swap Payment” means, with respect to each Swap Agreement, each periodic scheduled payment owing to the Swap Provider made with respect to the notional amount identified in such Swap Agreement. For purposes of the Indenture, “Swap Payment” excludes any non-scheduled payments, including but not limited to termination payments, indemnification payments, tax gross-up payments, expenses and default interest payments.

“Swap Payment Account” means the Account of that name in the Debt Service Fund established in the Indenture.

“Swap Payment Reserve Account” means the account of the Debt Service Fund established under the Indenture to cover potential basis risk between the Auction Rate on the Bonds and the variable rate payment on the Swap Agreements.

“*Swap Providers*” means the Initial Swap Providers and any other counterparty to a Swap Agreement.

“*Tax Agreement*” means the Tax Regulatory Agreement, dated the date of issuance of the Bonds, executed by the Board and the Trustee.

“*Tendered Bonds*” means Bonds tendered or deemed tendered for purchase pursuant to the Indenture.

“*Term Rate*” means for each Rate Period within a Term Rate Mode applicable to a Bond, a fixed per annum interest rate borne by such Bond established pursuant to the Indenture equal to the lowest interest rate which, in the judgment of the Remarketing Agent, would enable such Bond to be remarketed at the principal amount thereof on the Rate Change Date for such Rate Period.

“*Term Rate Conversion Date*” means an Adjustment Date for any Bond on which it begins to bear interest at a Term Rate.

“*Term Rate Mode*” means any Adjustment Period during which the Rate Determination Date and the Rate Change Date for each Rate Period therein (which shall have a duration which is not less than 12 months nor extend beyond the Maturity Date) shall occur on the first day of such Rate Period which shall be designated by the Remarketing Agent pursuant to the Indenture, and during which the Bonds which bear interest during such Adjustment Period bear interest at the Term Rate.

“*Trustee*” means Deutsche Bank National Trust Company, Chicago, Illinois, and any successor or successors appointed under the Indenture as hereinafter provided. The “principal corporate trust office” of the Trustee means 222 South Riverside Plaza, 24th Floor, Chicago, Illinois 60606, Attention: Corporate Trust Department.

“*Trust Estate*” means the Pledged State Aid Revenues, the Pledged Taxes and all other property pledged to the Trustee pursuant to the Indenture.

“*Trustee’s Agent*” means (i) the Trustee or (ii) any agent designated as Trustee’s Agent by the Trustee and at the time serving in that capacity. Any agent so designated by the Trustee shall execute a written agreement with the Trustee assuming all obligations of the Trustee hereunder with respect to those duties of the Trustee such agent agrees to perform on behalf of the Trustee.

“*Weekly Mode*” means an Interest Mode during which the rate of interest borne by the Bonds is determined on a weekly basis as set forth in the Indenture.

“*Weekly Rate*” means, for each Rate Period during any Weekly Mode, the rate of interest established pursuant to the Indenture equal to the lowest interest rate which, in the judgment of the Remarketing Agent, would enable such Bond to be remarketed at the principal amount thereof, plus accrued interest thereon, if any, on the Rate Change Date for such Rate Period.

“*Year*” or “*year*” means a calendar year.

Pledge of Trust Estate

In order to secure the payment of the principal of, premium, if any, and interest on all Bonds issued under the Indenture, according to the import thereof, and the performance and observance of each and every covenant and condition contained in the Indenture and in the Bonds, the Board pledges and grant in the Indenture a lien upon the following Trust Estate to the Trustee and its successors in trust and

assigns, for the benefit of the Owners, the Bank and the Bond Insurer, to the extent provided in the Indenture:

- (a) The Pledged State Aid Revenues and the Pledged Taxes;
- (b) All moneys and securities and earnings thereon in all Funds, Accounts and Sub-Accounts established pursuant to the Indenture, with the exception of the Bond Purchase Fund (which will be held exclusively for the payment of the purchase price of Tendered Bonds), the Program Expense Fund, and the Swap Payment Reserve Account; and
- (c) Any and all other moneys, securities and property furnished from time to time to the Trustee by the Board or on behalf of the Board or by any other persons to be held by the Trustee under the terms of the Indenture.

The Bonds Are General Obligations

The Bonds are at all times Outstanding the general obligation of the Board, for the payment of which its full faith and credit are pledged, and are payable, in addition to the Pledged State Aid Revenues, from the levy of Pledged Taxes, as described in the Indenture. The Bonds do not represent or constitute a debt of the Board within the meaning of any constitutional or any statutory limitation unless the Pledged Taxes have been extended for collection, in which case the Outstanding Bonds will be included in the computation of indebtedness of the Board for purposes of all statutory provisions or limitations until such time as an audit of the Board shows that the Bonds have been paid from the Pledged State Aid Revenues for a complete fiscal year of the Board.

Additional Bonds Payable From Pledged State Aid Revenues

The Board will not issue any bonds or other evidences of indebtedness other than the Bonds, which are secured by a pledge of or lien on the Pledged State Aid Revenues, the Pledged Taxes or the moneys, securities or funds held or set aside by the Board or by the Trustee under the Indenture except in accordance with the provisions of the Indenture. The Indenture authorizes the issuance of Additional Bonds payable from all or any portion of the Pledged State Aid Revenues or any other source of payment which may be pledged under the Debt Reform Act, and any such Additional Bonds will share ratably and equally in the Pledged State Aid Revenues with the Bonds; provided, however, that no Additional Bonds may be issued except in accordance with the provisions of the Debt Reform Act as in existence on the date of issuance of the Additional Bonds.

The Board reserves the right to issue bonds or other evidences of indebtedness payable from Pledged State Aid Revenues subordinate to the Bonds. Such subordinate obligations will be paid from Pledged State Aid Revenues available to the Board in each year in excess of those required to be deposited in the Pledged Revenues Account under the Indenture during such year.

Provisions Regarding Payment of Bonds

The principal of and premium, if any, on Bonds bearing interest at a Bank Rate, a Short Rate or an Auction Rate will be payable at the principal corporate trust office of the Trustee, upon presentation and surrender of such Bonds. The principal of and premium, if any, on Bonds bearing interest at a Term Rate or Fixed Rate will be payable at the principal corporate trust office of the Trustee or, at the option of the registered owner, at the principal corporate trust office of any Paying Agent, if any, named in any such Bond, upon presentation and surrender of such Bonds.

Interest on Bonds bearing interest at a Weekly Rate, Term Rate, an ARS Rate, Term Rate or a Fixed Rate will be paid by check mailed on the Interest Payment Date to the persons appearing on the Bond Register as the registered owners thereof as of the close of business of the Trustee on the Record Date at the address of such registered owners as they appear on the Bond Register or at such other addresses as are furnished to the Trustee in writing by such registered owners not later than the Record Date. Payment of interest on Bonds bearing interest at a Flexible Rate will be made to the persons appearing on the Bond Register as the registered owners thereof as of the close of business of the Trustee on the Record Date, upon presentation and surrender of such Bonds at the principal corporate trust office of the Trustee on the applicable Interest Payment Date. Payment of interest on any Bond will be made to registered owner of \$1,000,000 or more in aggregate principal amount of Bonds as of the close of business of the Trustee on the Record Date for a particular Interest Payment Date by wire transfer to such registered owner on such Interest Payment Date upon written notice from such registered owner containing the wire transfer address within the United States to which such registered owner wishes to have such wire directed, which written notice is received not later than the Business Day next preceding the Record Date; provided that such wire transfer will only be made for Bonds bearing interest at a Flexible Rate upon presentation and surrender of such Bonds at the principal corporate trust office of the Trustee on the applicable Interest Payment Date.

Provisions Regarding Transfer and Exchange of Bonds

Subject to the provisions described in the Official Statement under the heading “The Bonds—Book-Entry Only System” and in the immediately succeeding paragraph, upon surrender for registration of transfer of any Bond at the principal corporate trust office of the Trustee, duly endorsed by, or accompanied by a written instrument or instruments of transfer in form satisfactory to the Trustee and duly executed by the Owner or such Owner’s attorney duly authorized in writing, the Board will execute, and the Trustee will authenticate and deliver, in the name of the transferee or transferees a new Bond or Bonds of like date and tenor in Authorized Denominations of the same Maturity Date for the aggregate principal amount which the Owner is entitled to receive. Subject to the limitations contained in the immediately succeeding paragraph, Bonds may be exchanged at such times at such principal corporate trust office of the Trustee upon surrender thereof together with an assignment duly executed by the Owner thereof or such Owner’s attorney in such form and with guarantee of signature as is satisfactory to the Trustee for an equal aggregate principal amount of Bonds of like date and tenor of any Authorized Denomination as the Bonds surrendered for exchange. The execution by the Board of any Bond of any Authorized Denomination will constitute full and due authorization of such Authorized Denomination, and the Trustee will thereby be authorized to authenticate and deliver such registered Bond.

Subsequent to a Term Rate Conversion Date or the Fixed Rate Conversion Date for any Bond, the Trustee will not be required to transfer or exchange such Bond during the period commencing on the Record Date next preceding any Interest Payment Date of such Bond and ending on such Interest Payment Date, or to transfer or exchange such Bond after the mailing of notice calling such Bond for redemption has been made as provided in the Indenture or during the period of 15 days next preceding the giving of notice of redemption of Bonds of the same Maturity Date and interest rate which were converted on the same date. Prior to a Term Rate Conversion Date or the Fixed Rate Conversion Date applicable to any Bonds, the Trustee will not be required to exchange or register the transfer of such Bond after the mailing of notice calling such Bond for redemption has been made as provided in the Indenture, except that the Board and the Trustee will be required to issue or register the transfer of Tendered Bonds after such date of mailing of notice of redemption.

No service charge will be imposed upon the Owners for any exchange or transfer of Bonds. The Board and the Trustee may, however, require payment by the person requesting an exchange or transfer of Bonds of a sum sufficient to cover any tax, fee or other governmental charge that may be imposed in

relation thereto, except in the case of the issuance of a Bond or Bonds for the unredeemed portion of a Bond surrendered for redemption in part.

Establishment and Application of Project Fund

The Project Fund is established under the Indenture with the Trustee to be held and applied in accordance with the terms and provisions of the Indenture. Moneys on deposit in the Project Fund will be paid out from time to time by the Trustee to or upon the order of the Board in order to provide for the payment or to reimburse the Board for the payment of Project Costs upon receipt by the Trustee of a certificate of an Authorized Officer of the Board describing the Project Costs to be paid or reimbursed with such moneys and stating that:

- (i) the costs of an aggregate amount set forth in such certificate are necessary and appropriate Project Costs that (A) have been incurred and paid or (B) are expected to be paid within the next 60 days;
- (ii) the amount to be paid or reimbursed to the Board, as set forth in such certificate, is reasonable and represents a part of the amount payable for the Project Costs and that such payment is to be made or, in the case of reimbursement to the Board, was made, in accordance with the terms of any applicable contracts and in accordance with usual and customary practice under existing conditions;
- (iii) that no part of the Project Costs that are the subject of such certificate was included in any certificate previously filed with the Trustee under the provisions of the Indenture; and
- (iv) the use of the money so withdrawn from the Project Fund and the use of the facilities provided with such moneys will not result in a violation of any covenant, term or provision of the Tax Agreement.

Moneys in the Project Fund will be invested at the written direction of a Designated Official to the fullest extent practicable in Investment Securities maturing in such amounts and at such times as may be necessary to provide funds when needed to pay Project Costs or such other costs as may be required to be paid from such moneys. The Board may, and to the extent required for payments from the Project Fund will, direct the Trustee to sell any such Investment Securities at any time, and the proceeds of such sale, and of all payments at maturity and upon redemption of such investments, will be held in the Project Fund. Earnings received on moneys or securities in the Project Fund will be retained therein and applied to the purposes for which moneys in the Project Fund are otherwise held.

The completion, substantial completion or abandonment of the Project is to be evidenced by a certificate of an Authorized Officer, which is to be filed promptly with the Trustee, stating the date of such completion, anticipated completion or abandonment and the amount, if any, required in the opinion of the signer of such certificate for the payment of any remaining part of the Project Cost. Upon the filing of such certificate, the balance in the Project Fund in excess of the amount, if any, stated in such certificate of the Board as necessary to complete the Project will be deposited into such accounts of the Debt Service Fund as may be directed in such certificate.

Investment of Funds

Investment of Certain Moneys

Moneys held in the several Accounts and Sub-Accounts of the Debt Service Fund and in the Project Fund (but excluding any moneys derived from payments under the Bond Insurance Policy) will be invested and reinvested by the Trustee at the written direction of a Designated Official in Investment Securities within the parameters established in the Indenture and the Investment Policy which mature no later than necessary to provide moneys when needed for payments to be made from such Fund; provided, however, that the proceeds of the Liquidity Facility or the Bond Insurance Policy will only be invested in Government Obligations of the type described in clause (i) of the definition of such term. The Trustee may make any and all such investments through its trust department or the bond department of any bank (including the Trustee) or trust company under common control with the Trustee. All such investments made under the Indenture must be consistent with the expectations expressed in the Tax Agreement.

Valuation and Sale of Investments

Investment Securities in any Fund, Account or Sub-Account created under the Indenture will be deemed at all times to be part of such Fund, Account or Sub-Account and any profit realized from the liquidation of such investment will be credited to such Fund, Account or Sub-Account and any loss resulting from liquidation of such investment will be charged to such Fund, Account or Sub-Account. Valuations of Investment Securities held in the Funds, Accounts and Sub-Accounts established under the Indenture will be made by the Trustee as often as may be necessary or reasonably requested by the Board to determine the amounts held therein. In computing the amounts in such Funds, Accounts and Sub-Accounts, Investment Securities therein will be valued as provided in the following paragraph.

The value of Investment Securities will mean the fair market value thereof, provided, however, that all SLG's will be valued at par and those obligations which are redeemable at the option of the holder will be valued at the price at which such obligations are then redeemable.

Except as otherwise provided in the Indenture, the Trustee at the written direction of a Designated Official will sell at the best price obtainable, or present for redemption, any Investment Security held in any Fund, Account or Sub-Account held by the Trustee whenever it will be necessary to provide moneys to meet any payment or transfer from such Fund, Account or Sub-Account as the case may be.

Particular Covenants and Representations of the Board

Covenants Regarding Pledged State Aid Revenues

Pursuant to the Debt Reform Act, the Board covenants under the Indenture, so long as there are any Outstanding Bonds, to provide for, collect and apply the Pledged State Aid Revenues to the payment of the Bonds and the Swap Payments and the provision of not less than an additional .25 times debt service on the Bonds. The Board and its officers will comply with all present and future applicable laws, including the provisions of Article 18 of the School Code as the same currently exist or may be from time to time amended, in order to assure that the Pledged State Aid Revenues may be allocated and paid to the Board for application as provided in the Indenture.

Covenants Regarding Pledged Taxes

The Board has directed the County Collectors to deposit all collections of the Pledged Taxes, if and when extended for collection, directly with the Trustee for application in accordance with the provisions of the Indenture. So long as any of the Bonds remain Outstanding, the Board will not modify

or amend such direction, except for such modifications or amendments as may be necessitated by changes in State law or procedures or rules, regulations or procedures thereunder with respect to the collection and distribution of ad valorem property taxes; provided, that no such modification or amendment may provide for the deposit with the Trustee of less than all of the Pledged Taxes to be collected in any Year.

As described in the Official Statement under the heading “Security for the Bonds –Application of Pledged State Aid Revenues; Abatement of Pledged Taxes,” the Board will direct the abatement of the Pledged Taxes in whole or in part as described therein, and proper notification of any such abatement will be filed with (i) the County Clerks, in a timely manner to effect such abatement and (ii) the County Collectors, so as to advise such officers of the amount of the Pledged Taxes to be extended for the relevant levy year.

So long as there are any Outstanding Bonds, the Board and its officers will comply with all present and future applicable laws in order to assure that the Pledged Taxes may be levied and extended and collected and deposited to the Pledged Taxes Account as described above.

In furtherance of the general obligation, full faith and credit promise of the Board to pay the principal and Redemption Price of and interest on the Bonds, and in furtherance of the covenant of the Board to pay the Swap Payments, the Board will take all actions necessary to (i) cause the levy and extension of Pledged Taxes, including any Pledged Taxes required to be levied in excess of those levied pursuant to the Bond Resolution, for collection on a timely basis to make all such payments and (ii) to cause such Pledged Taxes when extended for collection to be deposited directly with the Trustee for application pursuant to the Indenture.

Accounts and Reports

The Board will keep proper books of record and account (separate from all other records and accounts) in which complete and correct entries will be made of its transactions relating to the Pledged State Aid Revenues, the Pledged Taxes and the Funds, Accounts and Sub-Accounts established by the Indenture, and which, together with all other books and financial records of the Board, will at all reasonable times be available for the inspection of the Trustee, the Bond Insurer and the Owners of not less than twenty-five percent (25%) in aggregate principal amount of Outstanding Bonds or their representatives duly authorized in writing.

Arbitrage

The Board will not at any time permit any of the proceeds of the Bonds or any other funds of the Board to be used directly or indirectly to acquire any securities or obligations the acquisition of which would cause any Bond to be an “arbitrage bond” as defined in the Code and Regulations.

Events of Default and Remedies

Events of Default

Each of the following events constitutes an Event of Default under the Indenture:

- (1) if a default occurs in the due and punctual payment of interest on any Bond, when and as such interest becomes due and payable;
- (2) if a default occurs in the due and punctual payment of the principal or Redemption Price of any Bond when and as the same becomes due and payable, whether at maturity or by call for redemption or otherwise;

(3) if a default occurs in the due and punctual payment of the purchase price of any Tendered Bond when and as the same becomes due and payable;

(4) if a default occurs in the performance or observance by the Board of any other of the covenants, agreements or conditions contained in the Indenture or in the Bonds, and such default continues for a period of 60 days after written notice thereof to the Board by the Trustee or after written notice thereof to the Board and to the Trustee by the Owners of not less than a majority in aggregate principal amount of the Outstanding Bonds; or

(5) if the Board files a petition seeking a composition of indebtedness under the federal bankruptcy laws or under any other applicable law or statute of the United States of America or of the State of Illinois.

A payment by the Bond Insurer pursuant to the Bond Insurance Policy will not be considered a payment by the Board for the purposes described in paragraphs (1) through (4) above.

Proceedings Brought By Trustee

There is no provision for the acceleration of the maturity of the Bonds if an Event of Default occurs under the Indenture.

If an Event of Default happens and is not remedied, then and in every such case, the Trustee, by its agents and attorneys, may proceed, and upon identical written request of the Owners of not less than a majority in aggregate principal amount of the Bonds Outstanding and upon being indemnified to its satisfaction will proceed, to protect and enforce its rights and the rights of the Owners of the Bonds under the Bonds or the Indenture forthwith by a suit or suits in equity or at law, whether for the specific performance of any covenant contained in the Indenture, or in aid of the execution of any power granted in the Indenture, or for an accounting against the Board as if the Board were the trustee of an express trust, or in the enforcement of any other legal or equitable right as the trustee, being advised by counsel, will deem most effectual to enforce any of its rights or to perform any of its duties under the Indenture or enforce any of the rights or interests of the Owners of the Bonds under the Bonds or the Indenture.

All rights of action under the Indenture may be enforced by the Trustee without the possession of any of the Bonds or the production thereof in any suit or other proceeding, and any such suit or other proceeding instituted by the Trustee shall be brought in its name.

All actions against the Board under the Indenture must be brought in a state or federal court located in the State of Illinois.

The Owners of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding may direct the time, method and place (subject to the preceding paragraph) of conducting any proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture or for the enforcement of any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee, provided that the Trustee will have the right to decline to follow any such direction if the Trustee is advised by counsel that the action or proceeding so directed may not lawfully be taken, or if the Trustee in good faith determines that the action or proceeding so directed would involve the Trustee in personal liability or be unjustly prejudicial to the Owners not parties to such direction.

Upon commencing any suit at law or in equity or upon commencement of other judicial proceedings by the Trustee to enforce any right under the Indenture, the Trustee shall be entitled to

exercise any and all rights and powers conferred in the Indenture and provided to be exercised by the Trustee upon the occurrence of any Event of Default.

Regardless of the happening of an Event of Default, the Trustee has the power, but unless requested in writing by the Owners of a majority in aggregate principal amount of the Bonds then Outstanding and furnished with reasonable security and indemnity, is under no obligation to institute and maintain such suits and proceedings as may be necessary or expedient to prevent any impairment of the security under the Indenture and to preserve or protect its interests and the interest of the Owners.

Application of Trust Estate and Other Moneys on Default

During the continuance of an Event of Default, the Trustee will apply all moneys, securities, funds, Pledged State Aid Revenues and Pledged Taxes and the income therefrom (other than amounts paid under the Bond Insurance Policy, which will be applied only to pay scheduled principal of and interest on the Bonds) as follows and in the following order:

- (1) to the payment of the reasonable and proper charges and expenses of the Trustee, including the reasonable fees and expenses of counsel employed by it; and
- (2) to the payment of the principal of, Redemption Price and interest on the Bonds then due, as follows:

FIRST: to the payment to the persons entitled thereto of all installments of interest then due on the Bonds in the order of the maturity of such installments, together with accrued and unpaid interest on the Bonds theretofore called for redemption, and, if the amount available is not sufficient to pay in full any installment or installments of interest maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the persons entitled thereto, without any discrimination or preference;

SECOND: to the payment to the persons entitled thereto of the unpaid principal or Redemption Price of any Bonds which has become due, whether at maturity or by call for redemption, in the order of their due dates, and, if the amount available is not sufficient to pay in full all the Bonds due on any date, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date, to the persons entitled thereto, without any discrimination or preference.

- (3) to the payment of the Swap Payments.

If and whenever all overdue installments of principal and Redemption Price of and interest on, Bonds, together with the reasonable and proper charges and expenses of the Trustee, and all other overdue sums payable by the Board under the Indenture, including the overdue principal and Redemption Price of and accrued unpaid interest on, all Bonds held by or for the account of the Board, and any and all unpaid Swap Payments, or provision satisfactory to the Trustee is made for such payments, and all defaults under the Indenture or the Bonds are made good or secured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate is made therefor and all amounts owed to the Bond Insurer are paid in full, the Trustee will pay over to the Board all moneys, securities and funds then remaining unexpended in the hands of the Trustee (except moneys, securities and funds deposited or pledged, or required by the terms of the Indenture to be deposited or pledged, with the Trustee), and thereupon the Board, the Trustee and the Owners will be restored, respectively, to their former positions and rights under the Indenture. No such payment over to the Board by the Trustee nor such restoration of the Board and the Trustee to their

former positions and rights will extend to or affect any subsequent default under the Indenture or impair any right consequent thereon.

Whenever moneys are to be applied as provided above, the Trustee may, in its discretion, establish and maintain a reserve for future fees and expenses, and may apply moneys to be distributed at such times, and from time to time, as the Trustee shall determine, having due regard for 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 shall apply such funds, it shall fix a date upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such dates, and for which moneys are available, shall cease to accrue. The Trustee shall also select a Record Date for such payment date. The Trustee shall give such notice as it may deem appropriate of the deposit with it of any moneys and of the fixing of any such Record Date and payment date, and shall not be required to make payment to the Owner of any Bond until such Bond shall be presented to the Trustee for appropriate endorsement or for cancellation if fully paid.

Rights of Bond Insurer to Direct Remedies

Notwithstanding anything in the Indenture to the contrary, so long as the Bond Insurance Policy is in full force and effect and the Bond Insurer has not failed to perform any of its obligations thereunder, the Bond Insurer, acting alone, will (i) have the right to direct all remedies granted hereunder upon the occurrence of an Event of Default, (ii) will be recognized as the registered owner of each Insured Bond for the purposes of exercising all such rights and privileges available to the Owners of such Insured Bonds, and the Bond Insurer will have the right to institute any suit, action, or proceeding at law or in equity under the same terms as an Owner of an Insured Bond in accordance with the Indenture.

Notwithstanding anything in the Indenture to the contrary, the Trustee on behalf of the Owners of Bonds shall have the absolute right at all times to enforce the provisions of the Liquidity Facility and the Bond Insurance Policy without any requirement of consent from either the Bank or the Bond Insurer.

Restrictions on Bondholders' Actions

No Owner of any Bond will have any right to institute any suit or proceeding at law or in equity for the enforcement or violation of any provision of the Indenture or the execution of any trust under the Indenture or for any remedy under the Indenture, unless such Owner has previously given to the Trustee written notice of the happening of an Event of Default, as provided in the Indenture, and the Owners of at least a majority in aggregate principal amount of the Bonds then Outstanding have filed a written request with the Trustee, and have offered it reasonable opportunity either to exercise the powers granted in the Indenture or by the laws of the State or to institute such suit or proceeding in its own name, and unless such Owners will have offered to the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee has refused or failed to comply with such request within 60 days after receipt by it of such notice, request and offer of indemnity, it being understood and intended that no one or more Owners of Bonds will have any right in any manner whatever by its or their action to affect, disturb or prejudice the pledge created by the Indenture or to enforce any right under the Indenture, except in the manner provided in the Indenture; and that all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had and maintained in the manner provided in the Indenture and for the equal benefit of all Owners of the Outstanding Bonds.

Nothing in the Indenture or in the Bonds contained shall affect or impair the general obligation, full faith and credit promise of the Board to pay at the respective dates of maturity and places therein expressed the principal of and interest on the Bonds to the respective Owners thereof, or affect or impair

the right of action of any Owner to enforce such payment of its Bond from the sources provided in the Indenture.

Remedies Conferred By The Debt Reform Act

The Board and the Trustee each acknowledge that Section 15(e) of the Debt Reform Act provides that all covenants of the Board relating to the issuance of the Bonds as alternate bonds pursuant to Section 15 of the Debt Reform Act and the conditions and obligations imposed by said Section 15 are enforceable by any Owner of the Bonds, any taxpayer of the Board and the people of the State of Illinois acting through the Attorney General of the State or any designee, and in the event that any such action results in an order finding that the Board has not properly collected and applied the Pledged State Aid Revenues as required by the Debt Reform Act, the plaintiff in any such action shall be awarded reasonable attorney's fees.

No Remedy Exclusive

No remedy by the terms of the Indenture conferred upon or reserved to the Trustee or the Owners is intended to be exclusive of any other remedy, but each remedy will be cumulative and will be in addition to every other remedy given under the Indenture or existing at law or in equity or by statute on or after the date of the execution and delivery of the Indenture.

No delay or omission of the Trustee or any Owner to exercise any right or power arising upon the happening of an Event of Default shall impair any right or power or shall be construed to be a waiver of any such default or be an acquiescence therein.

Waiver

The Owners of not less than two-thirds in aggregate principal amount of the Bonds at the time Outstanding, or their attorneys-in-fact duly authorized may on behalf of the Owners of all of the Bonds waive any past default under the Indenture and its consequences, except a default in the payment of interest on, or principal or Redemption Price of any of the Bonds when due. No such waiver will extend to any subsequent or other default or impair any right consequent thereon.

Provisions Relating to Trustee

Resignation and Removal of Trustee. The Trustee may at any time resign and be discharged of the duties and obligations imposed upon it by the Indenture by giving not less than 60 days' written notice to the Board, all Owners of the Bonds, the other Fiduciaries, the Remarketing Agent, the Auction Agent, the Bank and the Bond Insurer, and such resignation will take effect upon the day specified in such notice but only if a successor will have been appointed by the Board or the Owners as provided below, in which event such resignation will take effect immediately on the appointment of such successor whether or not the date specified for such resignation to take effect has arrived. If a successor Trustee has not been appointed within a period of 60 days following the giving of notice, then the Trustee is authorized to petition any court of competent jurisdiction to appoint a successor Trustee as described below.

The Trustee may be removed at any time by an instrument in writing approved by and executed in the name of the Board and delivered to the Trustee; provided, however, that if an Event of Default has occurred and is continuing, the Trustee may be so removed by the Board only with the written concurrence of the Owners of a majority in aggregate principal amount of Bonds then Outstanding. The Trustee may be removed at any time by the Owners of a majority in aggregate principal amount of the Bonds then Outstanding, excluding any Bonds held by or for the account of the Board, with Bond Insurer

Approval, by an instrument or concurrent instruments in writing signed and duly acknowledged by such Owners or their attorneys-in-fact duly authorized, and delivered to the Board.

Appointment of Successor Trustee. In case at any time the Trustee resigns or is removed or becomes incapable of acting, or is adjudged a bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, is appointed, or if any public officer or court takes charge or control of the Trustee, or of its property or affairs, the Board will appoint a successor Trustee. The Board will cause notice of any such appointment made by it to be mailed to all Owners of the Bonds and the Bond Insurer.

If no appointment of a Trustee is made by the Board within 60 days following such resignation or removal as described in the foregoing paragraph, the Trustee or the Owner of any Outstanding Bond may apply to any court of competent jurisdiction to appoint a successor Trustee. Such court may thereupon, after such notice, if any, as such court may deem proper and prescribe, appoint a successor Trustee.

Any successor Trustee appointed under the provisions of the Indenture must be a bank or trust company or national banking association, doing business and having its principal corporate trust office in the State of Illinois, and having capital stock and surplus aggregating at least \$15,000,000, or a wholly owned subsidiary of such an entity, if there be such a bank, trust company, national banking association or subsidiary willing and able to accept the office on reasonable and customary terms and authorized by law to perform all the duties imposed upon it by the Indenture.

Supplemental Indentures

Supplemental Indentures Not Requiring Consent of Owners. The Board and the Trustee may without the consent of, or notice to, any of the Owners, enter into a Supplemental Indenture or Supplemental Indentures for any one or more of the following purposes:

- (i) to impose additional covenants or agreements to be observed by the Board;
- (ii) to impose other limitations or restrictions upon the Board;
- (iii) to surrender any right, power or privilege reserved to or conferred upon the Board by the Indenture;
- (iv) to confirm, as further assurance, any pledge of or lien upon the Pledged State Aid Revenues, the Pledged Taxes or any other moneys, securities or funds;
- (v) to make any necessary amendments to or to supplement the Indenture in connection with the issuance of Additional Bonds as authorized herein;
- (vi) to cure any ambiguity, omission or defect in the Indenture;
- (vii) to provide for the appointment of a successor Securities Depository;
- (viii) to provide for the appointment of any successor Fiduciary;
- (ix) to provide for certificated Bonds;
- (x) to implement a conversion of the interest rate on all or any portion of the Bonds to a Fixed Rate, an ARS Rate or a different Short Rate, all as provided herein, including, but not limited to, modifying, amending or supplementing the form of Bond to reflect, among other things, a change in the designated title of the Bonds, the fixing of an annual rate of interest, the

termination of the rights of any Owner of Bonds to tender such Bonds for purchase, and the fact that the purchase price of, or interest on, the Bonds is no longer payable out of moneys drawn under the Liquidity Facility;

(xi) to amend the Auction Procedures in effect from time to time as authorized by the Indenture;

(xii) to evidence or give effect to, or facilitate, the delivery and administration under the Indenture of a Substitute Liquidity Agreement and a Substitute Liquidity Facility, including, but not limited to, such provisions as are necessary to permit the issuer of such a Substitute Liquidity Agreement to provide credit support relating to payment of principal of and interest on the Bonds and a separate issuer of another Substitute Liquidity Agreement to provide liquidity support relating to payment of the purchase price of Bonds delivered or deemed delivered hereunder for purchase;

(xiii) to evidence or give effect to, or facilitate, the delivery and administration under the Indenture of a Substitute Bond Insurance Policy;

(xiv) to evidence or give effect to or facilitate the delivery and administration under the Indenture of a letter of credit, a line of credit, a bond purchase agreement, an insurance policy or any other credit or liquidity device to secure the Bonds;

(xv) to secure or maintain ratings from any Rating Service in the highest short-term or commercial paper debt rating category, and the highest long-term debt rating category (each without giving effect to numeric or other qualifiers), of such Rating Service which are available for the Bonds, whether or not a Liquidity Facility secures the Bonds, which changes will not restrict, limit or reduce the obligation of the Board to pay the principal of, premium, if any, and interest on the Bonds as provided in the Indenture or otherwise adversely affect the Owners of the Bonds under the Indenture;

(xvi) to effect a change in the optional redemption schedule for Bonds in a Fixed Mode pursuant to the Indenture, or to effect a change in redemption price in accordance with the Indenture; and

(xvii) to make any other change which, in the judgment of the Trustee, does not materially adversely affect the rights of the Trustee or the Owners.

Supplemental Indentures Effective upon Consent of Owners. Any Supplemental Indenture not effective in accordance with the foregoing provisions will take effect only if permitted and approved and in the manner described below under the heading “Amendments — Consent of Owners.”

Consent of Bond Insurer. As long as (i) a Bond Insurance Policy is in effect, or (ii) the Bond Insurer Obligations remain unsatisfied, any Supplemental Indenture not effective as described under “Supplemental Indentures Not Requiring Consent of Owners” above will not become effective unless and until the Trustee has received Bond Insurer Approval. In this regard, the Trustee, at the Board’s direction, will cause notice of the proposed execution of any such Supplemental Indenture, together with a copy of the proposed Supplemental Indenture, to be mailed to the Bond Insurer at least fifteen Business Days prior to the proposed date of execution and delivery of such Supplemental Indenture. The Bond Insurer will be deemed to have denied consent to the execution and delivery of such Supplemental Indenture if the Trustee does not receive a letter of approval thereto signed by or on behalf of the Bank on or before the fifteenth Business Day after the mailing of said notice.

Amendments

General. Except for Supplemental Indentures not requiring consent of the Owners as described above, the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding and the Bond Insurer will each have the right, from time to time, to (i) consent to and approve the execution by the Board and the Trustee of such other Supplemental Indenture or Indentures as may be deemed necessary and desirable by the Board for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Indenture or in any supplemental indenture, or (ii) waive or consent to the taking by the Board of any action prohibited, or the omission by the Board of the taking of any action required, by any of the provisions of the Indenture or of any Supplemental Indenture; provided, however, that nothing in the Indenture permits or may be construed as permitting, (a) an extension of the stated maturity or reduction in the principal amount or reduction in the rate or extension of the time of paying of interest on, or reduction of any premium payable on the payment or redemption of any Bond, without the consent of the Owner of such Bond, or (b) a reduction in the amount of, or extension of the time of, any payment required by any sinking fund applicable to any Bonds without the consent of the Owners of all the Bonds which would be affected by the action to be taken, or (c) except for the pledge of the Pledged State Aid Revenues in connection with the issuance of Additional Bonds, the creation of any lien prior to or on a parity with the lien of the Indenture, without the consent of the Owners of all the Bonds at the time Outstanding, or (d) a reduction in the aforesaid aggregate principal amount of Bonds, the Owners of which are required to consent to any such waiver or Supplemental Indenture, without the consent of the Owners of all the Bonds at the time Outstanding which would be affected by the action to be taken, or (e) a modification of the rights, duties or immunities of the Trustee, without the written consent of the Trustee, or (f) the loss of the exclusion from federal gross income of the Owners of the interest paid on the Bonds held by a non-consenting Bondholder to the extent otherwise afforded under the Code and Regulations.

Consent of Owners and Bond Insurer. The Board may at any time authorize the execution and delivery of a Supplemental Indenture making a modification or amendment described in the preceding paragraph, to take effect when and as described in this paragraph. Upon the authorization of such Supplemental Indenture, a copy thereof will be delivered to and held by the Trustee for the inspection of the Owners. A copy of such Supplemental Indenture (or summary thereof or reference thereto in form approved by the Trustee) together with a request to Owners for their consent thereto in form satisfactory to the Trustee, will be mailed to the Owners, but failure to mail such copy and request will not affect the validity of such Supplemental Indenture when consented to as described below. Such Supplemental Indenture will not be effective unless and until, and will take effect in accordance with its terms when (a) there has been filed with the Trustee (i) the written consents of the Owners of the required aggregate principal amount of Outstanding Bonds and the Bond Insurer, and (ii) a Counsel's Opinion stating that the execution and delivery of such Supplemental Indenture has been duly authorized by the Board in accordance with the provisions of the Indenture, is authorized or permitted by the Indenture and, when effective, will be valid and binding upon the Board and the Trustee, and (b) the notice described below has been mailed. Any such consent will be binding upon the Owner of the Bonds giving such consent and upon any subsequent Owner of such Bonds and of any Bonds issued in exchange therefor whether or not such subsequent Owner has notice thereof, provided, however, that any consent may be revoked by any Owner of such Bonds by filing with the Trustee, prior to the time when the Trustee's written statement described below is filed, a written revocation, with proof that such Bonds are held by the signer of such revocation. The Trustee will give notice by mail to the Owners of the Bonds that the Supplemental Indenture has been consented to by the Owners of the required aggregate principal amount of Outstanding Bonds and will be effective (but failure to mail such notice or any defect therein will not prevent such Supplemental Indenture from becoming effective and binding).

The Indenture and the rights and obligations of the Board and of the Owners of the Bonds may be modified or amended in any respect by a Supplemental Indenture effecting such modification or amendment and with the consents of the Owners of all the Bonds then Outstanding and the Bond Insurer, each such consent to be accompanied by proof of the holding at the date of such consent of the Bonds with respect to which such consent is given. Such Supplemental Indenture will take effect upon the filing (a) with the Trustee of (i) a copy thereof, (ii) such consents and accompanying proofs and (iii) the Counsel's Opinion referred to in the preceding paragraph and (b) with the Board of the Trustee's written statement that the consents of the Owners of all Outstanding Bonds have been filed with it. No mailing or publication of any Supplemental Indenture (or reference thereto or summary thereof) or of any request or notice will be required.

Defeasance

If the Board pays or causes to be paid or there is otherwise paid to the Owners of all Bonds the principal or Redemption Price, if applicable, and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Indenture, and satisfies in full the Bond Insurer Obligations and the Bank Obligations, then the pledge of the Trust Estate pledged under the Indenture and all covenants, agreements and other obligations of the Board to the Owners, the Bond Insurer and the Bank will thereupon be discharged and satisfied. In such event, the Trustee, upon request of the Board, will provide an accounting of the assets managed by the Trustee to be prepared and filed with the Board for any year or part thereof requested, and will execute and deliver to the Board all such instruments as may be desirable to evidence such discharge and satisfaction, and the Paying Agent will pay over or deliver to the Board all moneys and securities held by it pursuant to the Indenture which are not required for the payment of Bonds not previously surrendered for such payment or redemption or the satisfaction of Bond Insurer Obligations or Bank Obligations. If the Board pays or causes to be paid, or there is otherwise paid, to the Owners of all Outstanding Bonds of a particular maturity or portion of any maturity (which portion will be selected by lot by the Trustee in the manner provided in the Indenture for the selection of Bonds to be redeemed in part), the principal or Redemption Price, if applicable, thereof and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Indenture and satisfies in full the Bond Insurer Obligations and the Bank Obligations specifically related thereto, such Bonds, Bond Insurer Obligations and Bank Obligations will cease to be entitled to any lien, benefit or security under the Indenture, and all covenants, agreements and obligations of the Board to the Owners of such Bonds, the Bond Insurer and the Bank and to the Trustee will thereupon be discharged and satisfied.

Bonds or interest installments for the payment or redemption of which moneys have been set aside and held in trust by the Trustee at or prior to their maturity or redemption date will be deemed to have been paid as described in the preceding paragraph if the Board has delivered to or deposited with the Trustee (a) irrevocable instructions to pay or redeem all of said Bonds in specified amounts no less than the respective amounts of, and on specified dates no later than the respective due dates of, their principal, (b) irrevocable instructions to publish or mail the required notice of redemption of any Bonds so to be redeemed, (c) either moneys in an amount which will be sufficient, or Defeasance Obligations the principal of and the interest on which, in the opinion of a nationally recognized firm of independent public accountants, without further reinvestment, when due will provide moneys which will be sufficient to pay when due the principal or Redemption Price, if applicable, and interest due and to become due on said Bonds on and prior to each specified redemption date or maturity date thereof, as the case may be, and (d) if any of said Bonds are not to be redeemed within the next succeeding 60 days, irrevocable instructions to mail to all Owners of said Bonds a notice that such deposit has been made with the Trustee and that said 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 or Redemption Price, if applicable, of said Bonds.

THE DEFEASANCE OBLIGATIONS (OR ANY PORTION THEREOF) HELD FOR THE PAYMENT OF THE PRINCIPAL AND REDEMPTION PRICE OF AND INTEREST ON SAID BONDS AS DESCRIBED IN THE PRECEDING PARAGRAPH MAY NOT BE SOLD, REDEEMED, INVESTED, REINVESTED OR REMOVED FROM THE LIEN OF THE INDENTURE IN ANY MANNER OR OTHER DEFEASANCE OBLIGATIONS SUBSTITUTED THEREFOR (ANY SUCH DIRECTION TO SELL, REDEEM, INVEST, REINVEST, REMOVE OR SUBSTITUTE TO BE REFERRED TO AS A "SUBSEQUENT ACTION") UNLESS PRIOR TO THE TAKING OF SUCH SUBSEQUENT ACTION, THE TRUSTEE HAS RECEIVED THE FOLLOWING: (I) EITHER (A) A CERTIFIED COPY OF THE PROCEEDINGS OF THE BOARD AUTHORIZING THE SUBSEQUENT ACTION, OR (B) AN OPINION OF COUNSEL FOR THE BOARD TO THE EFFECT THAT SUCH SUBSEQUENT ACTION HAS BEEN DULY AUTHORIZED BY ALL NECESSARY ACTION ON THE PART OF THE BOARD; (II) AN OPINION FROM A NATIONALLY RECOGNIZED FIRM OF INDEPENDENT PUBLIC ACCOUNTANTS TO THE EFFECT THAT THE DEFEASANCE OBLIGATIONS AND CASH AVAILABLE OR TO BE AVAILABLE FOR PAYMENT OF THE BONDS AFTER THE TAKING OF THE SUBSEQUENT ACTION WILL REMAIN SUFFICIENT TO PAY, WITHOUT ANY FURTHER REINVESTMENT THEREOF, THE PRINCIPAL AND REDEMPTION PRICE OF AND INTEREST ON SAID BONDS AT OR PRIOR TO THEIR MATURITY IN THE MANNER PROVIDED IN THE PRECEDING PARAGRAPH; (III) AN OPINION OF BOND COUNSEL TO THE EFFECT THAT THE SUBSEQUENT ACTION WILL NOT ADVERSELY AFFECT ANY EXEMPTION FROM FEDERAL INCOME TAX OF THE INTEREST PAID ON THE BONDS TO WHICH SUCH BONDS ARE OTHERWISE ENTITLED; AND (IV) SUCH OTHER DOCUMENTS AND SHOWINGS AS THE TRUSTEE MAY REASONABLY REQUIRE.

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APPENDIX C

FORM OF OPINION

[Date of Issuance of the Bonds]

Board of Education of the
City of Chicago
125 South Clark Street
Chicago, Illinois 60603

Lehman Brothers Inc.,
*as Representative of the Underwriters
named in the Contract of Purchase*
190 South LaSalle Street, 22nd Floor
Chicago, IL 60603

Deutsche Bank National Trust Company
222 S. Riverside Plaza, 24th Floor
Chicago, Illinois 60606

XL Capital Assurance Inc.
1221 Avenue of the Americas
New York, New York 10020

Re: Board of Education of the City of Chicago
Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D

Ladies and Gentlemen:

We have acted as Co-Bond Counsel in connection with the issuance by the Board of Education of the City of Chicago (the “Board”) of its \$257,925,000 aggregate principal amount Unlimited Tax General Obligation Bonds (Dedicated Revenues), Series 2003D (the “Bonds”). The Bonds are being issued in four sub-series consisting of \$50,025,000 aggregate principal amount of Series 2003D-1 Bonds, \$65,000,000 aggregate principal amount of Series 2003D-2 Bonds, \$71,450,000 aggregate principal amount of Series 2003D-3 Bonds, and \$71,450,000 aggregate principal amount of Series 2003D-4 Bonds. As Co-Bond Counsel, we have examined a certified copy of the record of proceedings of the Board, together with various accompanying certificates, pertaining to the issuance by the Board of the Bonds. The Bonds are being issued pursuant to a Trust Indenture dated as of December 1, 2003 (the “Indenture”), by and between the Board and Deutsche Bank National Trust Company, as trustee (the “Trustee”). The Bonds are issued pursuant to the authority of the School Code, 105 ILCS 5, the Local Government Debt Reform Act, 30 ILCS 350 and a resolution adopted by the Board on November 19, 2003, the “Bond Resolution”) and the Indenture. Capitalized terms used herein without definition shall have the meanings assigned to such terms in the Indenture.

The Bonds are issued for the purpose of (i) constructing, acquiring and equipping school and administrative buildings, site improvements and other real and personal property in and for the school district governed by the Board (the “School District”), (ii) paying certain costs of issuance of the Bonds, including bond insurance premium.

The Bonds are dated the date hereof, are being issued in fully registered form, and mature on the dates set forth in the Indenture. The Bonds of each sub-series are being initially issued in the Auction Rate Mode. As provided in the Indenture, the Bonds of a sub-series may bear interest from time to time at a Weekly Rate, a Flexible Rate, an Auction Rate or a Fixed Rate and under certain circumstances, the Bonds of a sub-series may bear interest at a Bank Rate, all pursuant to the terms and conditions of the Indenture.

In our capacity as Co-Bond Counsel, we have examined, among other things, the following:

(a) a certified copy of the proceedings of the Board adopting the Bond Resolution and authorizing, among other things, the execution and delivery of the Indenture and the issuance of the Bonds;

(b) a certified copy of the Bond Resolution;

(c) an executed counterpart of the Indenture; and

(d) such other certifications, documents, showings and related matters of law as we have deemed necessary in order to render this opinion.

Based upon the foregoing we are of the opinion that:

1. The Board has full power and authority and has taken all necessary corporate action to authorize the execution and delivery of the Indenture.

2. The Indenture has been duly and lawfully executed and delivered by the Board and, assuming its due authorization, execution and delivery by, and its binding effect on, the Trustee, the Indenture is valid and binding upon the Board and enforceable in accordance with its terms.

3. The Indenture creates the valid pledge which it purports to create of the Trust Estate held or set aside or pledged under the Indenture, subject to the application thereof to the purposes and on the conditions permitted by the Indenture.

4. The Bonds have been duly and validly authorized and issued in accordance with law and the Indenture and the Bonds, to the amount named, are valid and legally binding general obligations of the Board, enforceable in accordance with their terms and the terms of the Indenture.

5. The form of Bond prescribed for said issue is in due form of law.

6. The bonds are payable ratably and equally (i) from the "*Pledged Revenues*," being that amount of the State Aid payments to be made to the Board in any year pursuant to Article 18 of the School Code of the State of Illinois, as amended, or such successor or replacement fund or act as may be enacted in the future, not in excess of \$75,000,000 in any year, as shall provide for the payment of the Bonds, [and the provision of not less than an additional .25 times debt service on the Bonds] in such year and (ii) from the "*Pledged Taxes*," being the ad valorem taxes levied again all of the taxable property in the School district governed by the Board without limitation as to rate or amount for the payment of the Bonds. The Bonds are further secured by the other moneys, securities and funds pledged under the Indenture.

7. The Swap Payments described in the Indenture are payable from and secured by the pledged State Aid Revenues and the Pledged Taxes directly with the Trustee for application pursuant to the Indenture.

8. The Board has taken all necessary action to cause the County Collectors of The Counties of Cook and DuPage, Illinois, to deposit the Pledged Taxes directly with the Trustee for application pursuant to the Indenture.

9. Subject to the condition that the Board comply with certain covenants made to satisfy pertinent requirements of the Internal Revenue Code of 1986, as amended (the "Code"), under present law, the Bonds are not "private activity bonds" under Section 141 of the Code, and interest on the Bonds

is excludable from gross income of the owners thereof for federal income tax purposes. Interest on the Bonds will not be included as an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Bonds will be taken into account, however, in computing an adjustment used in determining the alternative minimum tax for certain corporations. Failure to comply with certain of these covenants could cause interest on the Bonds to be included in gross income retroactive to the date of issuance of the Bonds. Ownership of the Bonds may result in other federal tax consequences to certain taxpayers. We express no opinion regarding any such collateral consequences arising with respect to the Bonds. In rendering our opinion on tax exemption, we have relied upon certifications of the Board and certain other parties with respect to certain matters solely within its knowledge relating to the facilities to be financed or refinanced with the Bonds, the application of proceeds of the Bonds and certain other matters pertinent to the tax exempt status of the Bonds.

10. Interest on the Bonds is not exempt from Illinois income taxes.

The rights of the registered owners of the Bonds and the enforceability of provisions of the Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights. Enforcement of provisions of the Bonds and the Indenture by an equitable or similar remedy is subject to general principles of law or equity governing such a remedy, including the exercise of judicial discretion whether to grant any particular form of relief.

Respectfully submitted,

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APPENDIX D

SPECIMEN MUNICIPAL BOND INSURANCE POLICY

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**MUNICIPAL BOND
INSURANCE POLICY****ISSUER:** []**Policy No:** []**BONDS:** []**Effective Date:** []

XL Capital Assurance Inc. (XLCA), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. New York time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the Owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCA may, by giving written notice to the Trustee and the Paying Agent, appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy. From and after the date of receipt by the Trustee and the Paying Agent of such notice, which shall specify the name and notice address of the Insurer's Fiscal Agent, (a) copies of all notices required to be delivered to XLCA pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to XLCA and shall not be deemed received until received by both and (b) all payments required to be made by XLCA under this Policy may be made directly by XLCA or by the Insurer's Fiscal Agent on behalf of XLCA. The Insurer's Fiscal Agent is the agent of XLCA only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of XLCA to deposit or cause to be deposited sufficient funds to make payments due hereunder.

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

Name:
Title:

Name:
Title:

APPENDIX E

AUCTION PROCEDURES

Definitions

In addition to the words and terms elsewhere defined in the Indenture, the following words and terms have the following meanings with respect to Bonds in an ARS Rate Period unless the context or use indicates another or different meaning or intent:

“**Agent Member**” means a member of, or participant in, the Securities Depository who will act on behalf of a Bidder.

“**ARS Bonds**” means a Subseries of Bonds bearing interest at the ARS Rate.

“**ARS Index**” has the meaning specified under the heading “ARS Index.”

“**ARS Multiple**” means, as of any Auction Date, the Percentage of ARS Index (in effect on such Auction Date) determined as set forth below, based on the Prevailing Rating of the ARS Bonds in effect at the close of business on the Business Day immediately preceding such Auction Date:

<u>Prevailing Rating</u>	<u>Percentage of ARS Index</u>
AAA/Aaa/AAA	175%
AA/Aa/AA	250%
A/A/A	350%
BBB/Baa/BBB	450%
Below BBB/Baa/BBB.....	500%

“**ARS Rate**” means for each Subseries of ARS Bonds, the rates of interest to be borne by the ARS Bonds during each Auction Period determined as described in APPENDIX E; provided, in no event may the ARS Rates exceed the Maximum Interest Rate.

“**ARS Rate Adjustment Date**” means the date on which a Subseries of ARS Bonds convert from an Interest Mode other than an Auction Rate Mode and begin to bear interest at an ARS Rate.

“**ARS Rate Period**” means, with respect to any ARS Bonds which bear interest after the Initial Interest Period at a ARS Rate any period of time commencing on the day following the Initial Interest Period and ending on an Adjustment Date and with respect to any other ARS Bonds, any period of time commencing on an ARS Rate Adjustment Date and ending on an Adjustment Date.

“**Auction**” means each periodic implementation of the Auction Procedures.

“**Auction Agent**” means the auctioneer, if any, appointed in accordance with the provisions of the Indenture. The initial Auction Agent shall be Deutsche Bank Trust Company Americas.

“**Auction Agreement**” means an agreement between the Auction Agent and the Trustee pursuant to which the Auction Agent agrees to follow the procedures specified in the Indenture with respect to the ARS Bonds while bearing interest at a ARS Rate, as such agreement may from time to time be amended or supplemented.

“**Auction Date**” means, with respect to any Subseries of ARS Bonds, during any period in which the Auction Procedures are not suspended in accordance with the provisions of the Indenture (i) if the

ARS Bonds are in a Special Auction Period, the last Business Day of the Special Auction Period, and (ii) if the ARS Bonds are in any other Auction Period, the Business Day next preceding each Interest Payment Date for such ARS Bonds (whether or not an Auction will be conducted on such date); provided, however, that the last Auction Date with respect to the ARS Bonds in an Auction Period or a Special Auction Period will be the earlier of (a) the Business Day next preceding the Interest Payment Date next preceding the Adjustment Date on which ARS Bonds will be converted to another Interest Mode and (b) the Business Day next preceding the Interest Payment Date next preceding the Maturity Date for the ARS Bonds. The last Business Day of a Special Auction Period will be the Auction Date for the Auction Period which begins on the next succeeding Business Day, if any.

“Auction Period” means (i) a Special Auction Period, (ii) with respect to a Subseries of ARS Bonds in a seven-day mode, a period of generally seven days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on the day of the week designated by the Broker-Dealer thereafter (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) with respect to a Subseries of ARS Bonds in the 28-day mode, a period of generally 28 days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on such day of the fourth week thereafter designated by the Broker-Dealer (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) with respect to a Subseries of ARS Bonds in the 35-day mode, a period of generally 35 days beginning on the day of the week designated by the Broker-Dealer (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on such day of the week) and ending on such day of the fifth week thereafter designated by the Broker-Dealer (unless such day of the week is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (v) with respect to a Subseries of ARS Bonds in a three-month mode, a period of generally three months (or shorter period upon conversion from another Auction Period) beginning on the date following the last day of the prior Auction Period and ending on such same day of the week that is most closely three months following the beginning date of such Auction Period, and (vi) with respect to a Subseries of ARS Bonds in a six-month mode, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on such same day of the week that is most closely six months following the beginning date of such Auction Period. After the Initial Interest Periods and until converted to another Auction Period or another Interest Mode as provided in the Indenture, the Series 2003D-1 Bonds shall be in a 35-day mode, the Series 2003D-2 Bonds shall be in a 35-day mode and the Series 2003D-3 Bonds shall be in a 7-day mode.

“Auction Procedures” means the procedures for conducting Auctions described in this APPENDIX E.

“Auction Rate” means for Subseries of ARS Bonds for each Auction Period, (i) if Sufficient Clearing Bids exist, the Winning Bid Rate for such Subseries, provided, however, if all of the ARS Bonds are the subject of Submitted Hold Orders, the Minimum ARS Rate for the ARS Bonds and (ii) if Sufficient Clearing Bids do not exist, the Maximum ARS Rate for the ARS Bonds.

“Available Bonds” means for each Subseries of ARS Bonds on each Auction Date, the aggregate principal amount of ARS Bonds that are not the subject of Submitted Hold Orders.

“Bid” has the meaning specified under “Auction Procedures – Orders by Existing and Potential Owners.”

“Bidder” means each Existing Owner and Potential Owner who places an Order.

“Broker-Dealer” means any entity that is permitted by law to perform the function required of a Broker-Dealer described in the Indenture, that is a member of, or a direct participant in, the Securities Depository, and that is a party to a Broker-Dealer Agreement with the Auction Agent.

“Broker-Dealer Agreement” means an agreement among the Auction Agent, the Board and a Broker-Dealer pursuant to which such Broker-Dealer agrees to follow the Auction Procedures, as such Auction Procedures may from time to time be amended or supplemented.

“Broker-Dealer Rate” means a rate of 0.25% per annum with respect to the ARS Bonds or such different rates as may be established pursuant to a Broker-Dealer Agreement.

“Default Auction Rate” means, for ARS Bonds in respect of any Auction Period, a per annum rate equal to five hundred fifty percent (550%) of the ARS Index determined on the Auction Date next preceding the first day of such Auction Period, provided that in no event will the Default Rate exceed the Maximum Interest Rate.

“Existing Owner” means a Person who is listed as the beneficial owner of the ARS Bonds in the records of the Auction Agent.

“Hold Order” has the meaning specified under “Auction Procedures – Orders by Existing and Potential Owners.”

“Maximum ARS Rate” means, as of any Auction Date, a per annum rate equal to the product of the ARS Index multiplied by the ARS Multiple; provided that in no event will the Maximum ARS Rate exceed the Maximum Interest Rate.

“Minimum ARS Rate” means, as of any Auction Date, 45% of the ARS Index in effect on such Auction Date; provided that in no event will the Minimum ARS Rate exceed the Maximum Interest Rate

“No Auction Rate” means, as of any Auction Date, the rate determined by multiplying the Percentage of ARS Index set forth below, based on the Prevailing Rating of the ARS Bonds in effect at the close of business on the Business Day immediately preceding such Auction Date, by the ARS Index; provided that in no event will the No Auction Rate exceed the Maximum Interest Rate:

<u>Prevailing Rating</u>	<u>Percentage of ARS Index</u>
AAA/Aaa/AAA	65%
AA/Aa/AA	70%
A/A/A	85%
Below A/A/A	100%

“Order” means a Hold Order, Bid or Sell Order.

“Potential Owner” means any Person, including any Existing Owner, who may be interested in acquiring a beneficial interest in the ARS Bonds in addition to the ARS Bonds currently owned by such Person, if any.

“Prevailing Rating” means (a) AAA/Aaa/AAA, if the ARS Bonds have a rating of AAA or better by S&P and a rating of Aaa or better by Moody’s and a rating of AAA or better by Fitch, (b) if not AAA/Aaa/AAA, then AA/Aa/AA if the ARS Bonds have a rating of AA- or better by S&P, a rating of Aa3 or better by Moody’s and a rating of AA- or better by Fitch, (c) if not AAA/Aaa/AAA or AA/Aa/AA, then A/A/A if the ARS Bonds have a rating of A- or better by S&P, a rating of A3 or better by Moody’s and a rating of A- or better by Fitch, and (d) if not AAA/Aaa/AAA, AA/Aa/AA or A/A/A,

then BBB/Baa/BBB if the ARS Bonds shall have a rating of BBB- or better by S&P, a rating of Baa3 or better by Moody's and BBB- or better by Fitch and (e) if not AAA/Aaa/AAA, AA/Aa/AA, A/A/A or BBB/Baa/BBB, then below BBB/Baa/BBB, whether or not the ARS Bonds are rated by any securities rating agency. For purposes of this definition, (i) the ratings on the Bonds described above refer to the greater of the insured ratings on the Bonds or the underlying ratings on the Bonds and (ii) S&P's rating categories of "AAA," "AA," "A-" and "BBB," Moody's rating categories of "Aaa," "Aa3," "A3" and "Baa," and Fitch's rating categories of "AAA," "AA," "A," and "BBB" will be deemed to refer to and include the respective rating categories correlative thereto in the event that any such Rating Agencies have changed or modified their generic rating categories or if any successor thereto appointed in accordance with the definitions thereof will use different rating categories. If the ARS Bonds are not rated by a Rating Agency, the requirement of a rating by such Rating Agency will be disregarded. If the ratings for the ARS Bonds are split between two or more of the foregoing categories, the lower rating will determine the Prevailing Rating. If there is no rating, then the ARS Rate will be the Maximum ARS Rate.

"Principal Office" means, with respect to the Auction Agent, the office thereof designated in writing to the Board, the Trustee, and each Broker-Dealer.

"Securities Depository" means DTC and any other securities depository registered as a clearing agency with the Securities and Exchange Commission pursuant to Section 17A of the Securities Exchange Act of 1934, as amended, and appointed as the securities depository for the Bonds, provided that while any Bonds are in the Auction Mode, any such securities depository shall agree to follow the procedures required to be followed by such securities depository in connection with the ARS Bonds.

"Sell Order" has the meaning specified under "Auction Procedures – Orders by Existing and Potential Owners."

"Special Auction Period" means any period of not less than seven days and not more than 365 days to be determined by the Broker-Dealer which begins on an Interest Payment Date and ends on a date designated by the Broker-Dealer unless such date is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day.

"Statutory Maximum Rate" means the maximum rate permitted from time to time pursuant to applicable law, including the Bond Authorization Act of the State, as amended.

"Statutory Maximum Rate Failed Auction" means an Auction in which the ARS Rate determined pursuant to the application of the Auction Procedures, determined without regard to the application of the Statutory Maximum Rate, exceeds the Statutory Maximum Rate but does not exceed 15% or the rate equal to the product of the ARS Index multiplied by the ARS Multiple.

"Submission Deadline" means 1:00 p.m., New York City time, on each Auction Date for a series of ARS Bonds or such other time on such date as will be specified from time to time by the Auction Agent pursuant to the Auction Agreement as the time by which Broker-Dealers are required to submit Orders to the Auction Agent.

"Submitted Bid" has the meaning specified under "Auction Procedures – Determination of ARS Rate."

"Submitted Hold Order" has the meaning specified under "Auction Procedures – Determination of ARS Rate."

“Submitted Order” has the meaning specified under “Auction Procedures – Determination of ARS Rate.”

“Submitted Sell Order” has the meaning specified under “Auction Procedures – Determination of ARS Rate.”

“Sufficient Clearing Bids” means, with respect to a Subseries of ARS Bonds, an Auction for which the aggregate principal amount of ARS Bonds of such Subseries that are the subject of Submitted Bids by Potential Owners specifying one or more rates not higher than the Maximum ARS Rate is not less than the aggregate principal amount of ARS Bonds of such sub-series that are the subject of Submitted Sell Orders and of Submitted Bids by Existing Owners specifying rates higher than the Maximum ARS Rate.

“Winning Bid Rate” means, if Sufficient Clearing Bids exist, the lowest rate specified in Submitted Bids such that if: (i) each Submitted Bid from Existing Owners specifying such lowest rate and all other Submitted Bids from Existing Owners specifying lower rates were accepted, thus entitling such Existing Owners to continue to hold the principal amount of ARS Bonds subject to such Submitted Bids, and (ii) each Submitted Bid from Potential Owners specifying such lowest rate and all other Submitted Bids from Potential Owners specifying lower rates were accepted, then the Existing Owners described in clause (i) would continue to hold an amount of outstanding Bonds which, when added to the amount of outstanding Bonds to be purchased by Potential Holders described in clause (ii), would be equal to not less than the Available Bonds of such sub-series.

Auction Procedures

Orders by Existing Owners and Potential Owners.

- (a) Prior to the Submission Deadline on each Auction Date:
 - (i) each Existing Owner may submit to a Broker-Dealer, in writing or by such other method as shall be reasonably acceptable to such Broker-Dealer, information as to:
 - (A) the principal amount of the ARS Bonds, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period without regard to the rate determined by the Auction Procedures for such Auction Period,
 - (B) the principal amount of the ARS Bonds, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period if the rate determined by the Auction Procedures for such Auction Period shall not be less than the rate per annum then specified by such Existing Owner (and which such Existing Owner irrevocably offers to sell on the next succeeding Interest Payment Date if the rate determined by the Auction Procedures for the next succeeding Auction Period shall be less than the rate per annum then specified by such Existing Owner), and/or
 - (C) the principal amount of the ARS Bonds, if any, held by such Existing Owner which such Existing Owner irrevocably offers to sell on the next succeeding Interest Payment Date without regard to the rate determined by the Auction Procedures for the next succeeding Auction Period; and

(ii) for the purpose of implementing the Auctions and thereby to achieve the lowest possible interest rate on the ARS Bonds, the Broker-Dealers shall contact Potential Owners, including Persons that are Existing Owners, to determine the principal amount of the ARS Bonds, if any, which each such Potential Owner irrevocably offers to purchase if the rate determined by the Auction Procedures for the next succeeding Auction Period is not less than the rate per annum then specified by such Potential Owner.

For the purposes hereof, an Order containing the information referred to in clause (i)(A) above is herein referred to as a “Hold Order,” an Order containing the information referred to in clause (i)(B) or (ii) above is herein referred to as a “Bid”, and an Order containing the information referred to in clause (i)(C) above is herein referred to as a “Sell Order.”

(b) (i) A Bid by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of the ARS Bonds specified in such Bid if the rate determined by the Auction Procedures on such Auction Date shall be less than the rate specified therein; or

(B) such principal amount or a lesser principal amount of the ARS Bonds to be determined as described in subsection (a)(v) of the section below entitled “Allocation of ARS Bonds” if the rate determined by the Auction Procedures on such Auction Date shall be equal to such specified rate; or

(C) a lesser principal amount of the ARS Bonds to be determined as described in subsection (b)(iv) of the section below entitled “Allocation of ARS Bonds” if such specified rate shall be higher than the Maximum ARS Rate and Sufficient Clearing Bids do not exist.

(ii) A Sell Order by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of the ARS Bonds specified in such Sell Order; or

(B) such principal amount or a lesser principal amount of the ARS Bonds as described in subsection (b)(iv) of the section below entitled “Allocation of ARS Bonds” if Sufficient Clearing Bids do not exist.

(iii) A Bid by a Potential Owner shall constitute an irrevocable offer to purchase:

(A) the principal amount of the ARS Bonds specified in such Bid if the rate determined by the Auction Procedures on such Auction Date shall be higher than the rate specified therein; or

(B) such principal amount or a lesser principal amount of the ARS Bonds as described in subsection (a)(vi) of the section below entitled “Allocation of ARS Bonds” if the rate determined by the Auction Procedures on such Auction Date shall be equal to such specified rate.

(c) Anything herein to the contrary notwithstanding:

(i) for purposes of any Auction, any Order which specifies the ARS Bonds to be held, purchased or sold in a principal amount which is not equal to the authorized denomination for Bonds or an integral multiple thereof shall be rounded down to the nearest amount that is

equal to the Authorized Denomination for Bonds, and the Auction Agent shall conduct the Auction Procedures as if such Order had been submitted in such lower amount;

(ii) for purposes of any Auction, any portion of an Order of an Existing Owner which relates to the ARS Bond which has been called for redemption on or prior to the Interest Payment Date next succeeding such Auction shall be invalid with respect to such portion and the Auction Agent shall conduct the Auction Procedures as if such portion of such Order had not been submitted;

(iii) for purposes of any Auction, no portion of the ARS Bond which has been called for redemption on or prior to the Interest Payment Date next succeeding such Auction shall be included in the calculation of Available Bonds for such Auction; and

(iv) the Auction Procedures shall be suspended during the period commencing on the date of the Auction Agent's receipt of notice from the Trustee or the Board of the occurrence of a payment default by the Board and the failure by the Bond Insurer to pay amounts due under the Bond Insurance Policy and shall resume two Business Days after the date on which the Auction Agent receives notice from the Trustee that such default has been cured, with the next Auction to occur on the next regularly scheduled Auction Date occurring thereafter.

Submission of Orders by Broker-Dealers to Auction Agent.

(a) Each Broker-Dealer shall submit to the Auction Agent in writing or by such other method as shall be reasonably acceptable to the Auction Agent, including such electronic communication acceptable to the parties, prior to the Submission Deadline on each Auction Date, all Orders obtained by such Broker-Dealer and, if requested, specifying with respect to each Order:

(i) the aggregate principal amount of the ARS Bonds, if any, that are the subject of such Order;

(ii) to the extent that such Bidder is an Existing Owner:

(A) the principal amount of the ARS Bonds, if any, subject to any Hold Order placed by such Existing Owner;

(B) the principal amount of the ARS Bonds, if any, subject to any Bid placed by such Existing Owner and the rate specified in such Bid; and

(C) the principal amount of the ARS Bonds, if any, subject to any Sell Order placed by such Existing Owner;

(iii) to the extent such Bidder is a Potential Owner, the rate specified in such Bid.

(b) If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent shall round such rate up to the next highest one thousandth of one percent (0.001%).

(c) If an Order or Orders covering all of the ARS Bonds held by an Existing Owner is not submitted to the Auction Agent prior to the Submission Deadline, the Auction Agent shall deem a Hold Order to have been submitted on behalf of such Existing Owner covering the principal amount of the ARS Bonds held by such Existing Owner and not subject to Orders submitted to the Auction Agent; but that if there is a conversion from one Auction Period to another Auction Period and Orders have not been

submitted to the Auction Agent prior to the Submission Deadline covering the aggregate principal amount of the ARS Bonds to be converted held by such Existing Owner, the Auction Agent shall deem a Sell Order to have been submitted on behalf of such Existing Owner covering the principal amount of ARS Bonds to be converted held by such Existing Owner not subject to Orders submitted to the Auction Agent.

(d) If one or more Orders covering in the aggregate more than the principal amount of Outstanding ARS Bonds held by any Existing Owner are submitted to the Auction Agent, such Orders shall be considered valid as follows:

(i) all Hold Orders shall be considered Hold Orders, but only up to and including in the aggregate the principal amount of the ARS Bonds held by such Existing Owner;

(ii) (A) any Bid of an Existing Owner shall be considered valid as a Bid of an Existing Owner up to and including the excess of the principal amount of the ARS Bonds held by such Existing Owner over the principal amount of the ARS Bonds subject to Hold Orders referred to in paragraph (i) above;

(B) subject to clause (A) above, all Bids of an Existing Owner with the same rate shall be aggregated and considered a single Bid of an Existing Owner up to and including the excess of the principal amount of the ARS Bonds held by such Existing Owner over the principal amount of the ARS Bonds held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above;

(C) subject to clause (A) above, if more than one Bid with different rates is submitted on behalf of such Existing Owner, such Bids shall be considered Bids of an Existing Owner in the ascending order of their respective rates up to the amount of the excess of the principal amount of the ARS Bonds held by such Existing Owner over the principal amount of the ARS Bonds held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above; and

(D) the principal amount, if any, of such ARS Bonds of such Subseries subject to Bids not considered to be Bids of an Existing Owner under this paragraph (ii) shall be treated as the subject of a Bid by a Potential Owner;

(iii) all Sell Orders shall be considered Sell Orders, but only up to and including a principal amount of the ARS Bonds equal to the excess of the principal amount of the ARS Bonds held by such Existing Owner over the sum of the principal amount of the ARS Bonds considered to be subject to Hold Orders pursuant to paragraph (i) above and the principal amount of ARS Bonds considered to be subject to Bids of such Existing Owner pursuant to paragraph (ii) above.

(e) If more than one Bid is submitted on behalf of any Potential Owner, each Bid submitted with the same rate shall be aggregated and considered a single Bid and each Bid submitted with a different rate shall be considered a separate Bid with the rate and the principal amount of ARS Bonds specified therein.

(f) Neither the Board, the Trustee nor the Auction Agent shall be responsible for the failure of any Broker-Dealer to submit an Order to the Auction Agent on behalf of any Existing Owner or Potential Owner.

(g) Any Bid Submitted by an Existing Owner or a Potential Owner specifying a rate lower than the Minimum ARS Rate, if any, shall be treated as a Bid specifying the Minimum ARS Rate.

Determination of ARS Rate.

(a) Not later than 9:30 a.m., New York City time, on each Auction Date for each Subseries of ARS Bonds, the Auction Agent shall advise the Broker-Dealers and the Trustee by telephone or other electronic communication acceptable to the parties of the Minimum ARS Rate, the Maximum ARS Rate and the ARS Index for the ARS Bonds.

(b) Promptly after the Submission Deadline on each Auction Date for each Subseries of ARS Bonds, the Auction Agent shall assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to as a "Submitted Hold Order," a "Submitted Bid" or a "Submitted Sell Order," as the case may be, and collectively as a "Submitted Order") and shall determine (i) the Available Bonds, (ii) whether there are Sufficient Clearing Bids, and if so, the Winning Bid Rate, and (iii) the Auction Rate.

(c) Promptly after the Auction Agent has made the determinations pursuant to subsection (b) above, the Auction Agent shall advise the Trustee by telephone (promptly confirmed in writing), telex or facsimile transmission or other electronic communication acceptable to the parties of the Auction Rate for the next succeeding Auction Period and the Trustee shall promptly notify DTC of such Auction Rate.

(d) In the event the Auction Agent fails to calculate, or for any reason fails to timely provide, the Auction Rate for any Auction Period, the Auction Rate for such Auction Period shall be the No Auction Rate; but if the Auction Procedures are suspended due to the failure of both the Board and the Bond Insurer to pay the principal of or interest on any Bond, the ARS Rate for the next succeeding Auction Period and each succeeding Auction Period commencing prior to two (2) Business Days after the date on which such payment default shall have ceased to continue shall be the Default Auction Rate.

(e) In the event that all of the conditions for a change in the Interest Mode applicable to the ARS Bonds from an Auction Rate Mode to any other Interest Mode have not been met or in the event of a failure to change the length of the current Auction Period due to the lack of Sufficient Clearing Bids at the Auction on the Auction Date for the first new Auction Period, the ARS Rates for the next Auction Period shall be the Maximum ARS Rate and the Auction Period shall be a seven-day Auction Period.

(f) If the ARS Bonds are no longer maintained in book-entry form by the Securities Depository, then the ARS Rates for the subsequent Auction Period shall be the Maximum ARS Rate and such Auction Period shall be for seven days.

Allocation of ARS Bonds.

(a) In the event of Sufficient Clearing Bids for a Subseries of ARS Bonds, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for such Bonds shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Bonds that are the subject of such Submitted Hold Order;

(ii) the Submitted Sell Order of each Existing Owner shall be accepted and the Submitted Bid of each Existing Owner specifying any rate that is higher than the Winning Bid

Rate shall be rejected, thus requiring each such Existing Owner to sell the ARS Bonds that are the subject of such Submitted Sell Order or Submitted Bid;

(iii) the Submitted Bid of each Existing Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Bonds that are the subject of such Submitted Bid;

(iv) the Submitted Bid of each Potential Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the ARS Bonds that are the subject of such Submitted Bid;

(v) the Submitted Bid of each Existing Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Bonds that are the subject of such Submitted Bid, but only up to and including the principal amount of ARS Bonds obtained by multiplying (A) the aggregate principal amount of Outstanding ARS Bonds which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraph (iii) or (iv) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Bonds held by such Existing Owner subject to such Submitted Bid and the denominator of which shall be the aggregate principal amount of Outstanding ARS Bonds subject to such Submitted Bids made by all such Existing Owners that specified a rate equal to the Winning Bid Rate, and the remainder, if any, of such Submitted Bid shall be rejected, thus requiring each such Existing Owner to sell any excess amount of ARS Bonds;

(vi) the Submitted Bid of each Potential Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the ARS Bonds that are the subject of such Submitted Bid, but only in an amount equal to the principal amount of ARS Bonds obtained by multiplying (A) the aggregate principal amount of Outstanding ARS Bonds which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii), (iv) or (v) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Bonds subject to such Submitted Bid and the denominator of which shall be the sum of the aggregate principal amount of Outstanding ARS Bonds subject to such Submitted Bids made by all such Potential Owners that specified a rate equal to the Winning Bid Rate, and the remainder of such Submitted Bid shall be rejected; and

(vii) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Winning Bid Rate shall be rejected.

(b) In the event there are not Sufficient Clearing Bids for ARS Bonds, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for ARS Bonds shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Bonds that are the subject of such Submitted Hold Order;

(ii) the Submitted Bid of each Existing Owner specifying any rate that is not higher than the Maximum ARS Rate, shall be accepted, thus requiring each such Existing Owner to continue to hold the ARS Bonds that are the subject of such Submitted Bid;

(iii) the Submitted Bid of each Potential Owner specifying any rate that is not higher than the Maximum ARS Rate, shall be accepted, thus requiring each such Potential Owner to purchase the ARS Bonds that are the subject of such Submitted Bid;

(iv) the Submitted Sell Orders of each Existing Owner shall be accepted as Submitted Sell Orders and the Submitted Bids of each Existing Owner specifying any rate that is higher than the Maximum ARS Rate, shall be deemed to be and shall be accepted as Submitted Sell Orders, in both cases only up to and including the principal amount of ARS Bonds obtained by multiplying (A) the aggregate principal amount of ARS Bonds subject to Submitted Bids described in paragraph (iii) of this subsection (b) by (B) a fraction the numerator of which shall be the principal amount of Outstanding ARS Bonds held by such Existing Owner subject to such Submitted Sell Order or such Submitted Bid deemed to be a Submitted Sell Order and the denominator of which shall be the principal amount of Outstanding ARS Bonds subject to all such Submitted Sell Orders and such Submitted Bids deemed to be Submitted Sell Orders, and the remainder of each such Submitted Sell Order or Submitted Bid shall be deemed to be and shall be accepted as a Hold Order and each such Existing Owner shall be required to continue to hold such excess amount of the ARS Bonds; and

(v) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Maximum ARS Rate shall be rejected.

(c) If, as a result of the procedures described in subsection (a) or (b) above, any Existing Owner or Potential Owner would be required to purchase or sell an aggregate principal amount of the ARS Bonds which is not an integral multiple of the authorized denomination for Bonds on any Auction Date, the applicable Broker-Dealer shall by lot, in such manner as it shall determine in its sole discretion, round up or down the principal amount of the ARS Bonds to be purchased or sold by any Existing Owner or Potential Owner on such Auction Date so that the aggregate principal amount of the ARS Bonds purchased or sold by each Existing Owner or Potential Owner on such Auction Date shall be an Authorized Denomination, even if such allocation results in one or more of such Existing Owners or Potential Owners not purchasing or selling any Bonds on such Auction Date.

(d) If, as a result of the procedures described in subsection (a) above, any Potential Owner would be required to purchase a principal amount of ARS Bonds that is less than the authorized denomination for Bonds on any Auction Date, the applicable Broker-Dealer shall by lot, in such manner as it shall determine in its sole discretion, allocate such ARS Bonds for purchase among Potential Owners so that the principal amount of ARS Bonds purchased on such Auction Date by any Potential Owner shall be an Authorized Denomination, even if such allocation results in one or more of such Potential Owners not purchasing such ARS Bonds on such Auction Date.

Notice of ARS Rate.

(a) On each Auction Date, the Auction Agent shall notify by telephone or other telecommunication device or other electronic communication acceptable to the parties or in writing each Broker-Dealer that participated in the Auction held on such Auction Date of the following with respect to Bonds for which an Auction was held on such Auction Date:

(i) the ARS Rate determined on such Auction Date for the succeeding Auction Period;

(ii) whether Sufficient Clearing Bids existed for the determination of the Winning Bid Rate;

(iii) if such Broker-Dealer submitted a Bid or a Sell Order on behalf of an Existing Owner, whether such Bid or Sell Order was accepted or rejected and the principal amount of the ARS Bonds, if any, to be sold by such Existing Owner;

(iv) if such Broker-Dealer submitted a Bid on behalf of a Potential Owner, whether such Bid was accepted or rejected and the principal amount of the ARS Bonds, if any, to be purchased by such Potential Owner;

(v) if the aggregate principal amount of the ARS Bonds to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted Bids or Sell Orders is different from the aggregate principal amount of the ARS Bonds to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid, the name or names of one or more Broker-Dealers (and the Agent Member, if any, of each such other Broker-Dealer) and the principal amount of the ARS Bonds to be (A) purchased from one or more Existing Owners on whose behalf such other Broker-Dealers submitted Bids or Sell Orders or (B) sold to one or more Potential Owners on whose behalf such Broker-Dealer submitted Bids; and

(vi) the immediately succeeding Auction Date.

(b) On each Auction Date, with respect to each Subseries of ARS Bonds for which an Auction was held on such Auction Date, each Broker-Dealer that submitted an Order on behalf of any Existing Owner or Potential Owner shall: (i) advise each Existing Owner and Potential Owner on whose behalf such Broker-Dealer submitted an Order as to (A) the ARS Rates determined on such Auction Date, (B) whether any Bid or Sell Order submitted on behalf of each such Owner was accepted or rejected and (C) the immediately succeeding Auction Date; (ii) instruct each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, to instruct such Existing Owner's Agent Member to pay to such Broker-Dealer (or its Agent Member) through the Securities Depository the amount necessary to purchase the principal amount of such ARS Bonds to be purchased pursuant to such Bid against receipt of such ARS Bonds; and (iii) instruct each Existing Owner on whose behalf such Broker-Dealer submitted a Sell Order that was accepted or a Bid that was rejected, in whole or in part, to instruct such Existing Owner's Agent Member to deliver to such Broker-Dealer (or its Agent Member) through the Securities Depository the principal amount of such Bonds to be sold pursuant to such Bid or Sell Order against payment therefor.

ARS Index.

(a) The ARS Index on any Auction Date with respect to the ARS Bonds in any Auction Period of 35 days or less shall be the greater of (i) Thirty-Day "AA" Composite Non-Financial Commercial Paper Rate on such date or (ii) one-month LIBOR, if any, on such date. The ARS Index with respect to the ARS Bonds in any Auction Period greater than 35 days shall be the greater of (a) the rate on United States Treasury Securities having a maturity which most closely approximates the length of the Auction Period, as last published in The Bond Buyer or (b) LIBOR, if any, which most closely approximates the length of the Auction Period on such Auction Date. If either rate is unavailable, the ARS Index shall be an index or rate agreed to by all Broker-Dealers and consented to by the Board and the Bond Insurer.

"Thirty-Day "AA" Composite Non-Financial Commercial Paper Rate" on any date of determination, means the interest equivalent of the thirty-day rate on commercial paper placed on behalf of non-financial issuers whose corporate bonds are rated AA by S&P, or the equivalent of such rating by S&P, as made available on a discount basis or otherwise by the Federal Reserve Bank of New York for the Business Day immediately preceding such date of determination, or if the Federal Reserve Bank of New York does not make available any such rate, then the arithmetic average of such rates, as quoted on a

discount basis or otherwise, by Lehman Commercial Paper Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated or, in lieu of any thereof, their respective affiliates or successors which are commercial paper dealers (the “Commercial Paper Dealers”), to the Auction Agent before the close of business on the Business Day immediately preceding such date of determination.

For purposes of the definitions of Thirty-Day “AA” Composite Non-Financial Commercial Paper Rate, the “interest equivalent” means the equivalent yield on a 360 day basis of a discount-basis security to an interest-bearing security. If any Commercial Paper Dealer does not quote a commercial paper rate required to determine the Thirty-Day “AA” Composite Non-Financial Commercial Paper Rate, the Thirty-Day “AA” Composite Non-Financial Commercial Paper Rate shall be determined on the basis of the quotation or quotations furnished by the remaining Commercial Paper Dealer and any substitute commercial paper dealer not included within the definition of Commercial Paper Dealer above, which may be Goldman, Sachs & Co., Morgan Stanley & Co., Incorporated or Salomon Smith Barney Inc. or their respective affiliates or successors which are commercial paper dealers (a “Substitute Commercial Paper Dealer”) selected by the Board (who shall be under no liability for such selection) to provide such commercial paper rate or rates not being supplied by any Commercial Paper Dealer or Commercial Paper Dealers, as the case may be, or if the Board does not select any such Substitute Commercial Paper Dealer or Substitute Commercial Paper Dealers, by the remaining Commercial Paper Dealer or Commercial Paper Dealers.

(b) If for any reason on any Auction Date the ARS Index shall not be determined as hereinabove provided in this Section, the ARS Index shall be the ARS Index for the Auction Period ending on such Auction Date.

(c) The determination of the ARS Index as provided herein shall be conclusive and binding upon the Board, the Trustee, the Broker-Dealers, the Auction Agent and the Owners of the Bonds.

Miscellaneous Provisions Regarding Auctions.

(a) Each reference herein to purchase, sale or holding of ARS Bonds will refer to beneficial interests in ARS Bonds, unless the context clearly requires otherwise.

(b) The Board may provide by Supplemental Indenture delivered pursuant to the Indenture for the amendment of the Auction Procedures in effect from time to time in order to conform such procedures to the then-current market practices by delivering an Opinion of Bond Counsel to the effect that such amendment is (i) authorized or permitted by the Indenture, (iii) will not have an adverse effect on the exclusion from gross income for federal income tax purposes of the interest on the Bonds and (iii) will not have an adverse effect on the validity or enforceability of the Bonds. See APPENDIX B—“SUMMARY OF CERTAIN PROVISIONS OF THE INDENTURE.” Notwithstanding the preceding sentence, during an ARS Rate Period the definitions of Broker-Dealer Rate, Default Auction Rate, Maximum ARS Rate, Minimum ARS Rate, No Auction Rate, ARS Index, ARS Multiple and ARS Rates, may not be amended pursuant to the Indenture without obtaining the consent of the Bond Insurer and the owners of all Outstanding ARS Bonds bearing interest at a ARS Rates as follows. If on the first Auction Date occurring at least 20 days after the date on which the Trustee mailed notice of such proposed amendment to the registered owners of the Outstanding ARS Bonds as required by the Indenture, (i) the ARS Rates which are determined on such date are the Winning Bid Rates and (ii) there is delivered to the Board, the Bond Insurer and the Trustee an Opinion of Bond Counsel to the effect that such amendment will not adversely affect the validity of the ARS Bonds or any exemption from federal income tax to which the interest on the ARS Bonds would otherwise be entitled, the proposed amendment will be deemed to have been consented to by the owners of all affected Outstanding ARS Bonds bearing interest at the ARS Rates.

(c) During an ARS Rate Period, so long as the ownership of the ARS Bonds is maintained in book-entry form by the Securities Depository, an Existing Owner or a beneficial owner may sell, transfer or otherwise dispose of an ARS Bond only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or to or through a Broker-Dealer, provided that (i) in the case of all transfers other than pursuant to Auctions such Existing Owner or its Broker-Dealer or its Agent Member advises the Auction Agent of such transfer and (ii) a sale, transfer or other disposition of ARS Bonds from a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer as the holder of such ARS Bonds to that Broker-Dealer or another customer of that Broker-Dealer will not be deemed to be a sale, transfer or other disposition for purposes of this paragraph if such Broker-Dealer remains the Existing Owner of the ARS Bonds so sold, transferred or disposed of immediately after such sale, transfer or disposition.

Changes in Auction Period or Auction Date.

(a) Changes in Auction Period.

(i) During any ARS Rate Period, the Board may from time to time on any Interest Payment Date, change the length of the Auction Period with respect to any of the ARS Bonds among seven days, 28 days, 35 days, three months, six months and a Special Auction Period. The Board shall initiate the change in the length of the Auction Period by giving written notice to the Trustee, the Bond Insurer, the Auction Agent, the Broker-Dealers and the Securities Depository that the Auction Period for the ARS Bonds specified in such notice shall change if the conditions described herein are satisfied and the proposed effective date of the change, at least 10 Business Days prior to the Auction Date for such Auction Period; except that in the case of a change from a Special Auction Period of 92 or more days, the date of such change shall be the Interest Payment Date immediately following the last day of such Special Auction Period.

(ii) The change in length of the Auction Period shall take effect only if Sufficient Clearing Bids exist at the Auction on the Auction Date for such first Auction Period. For purposes of the Auction for the first Auction Period only, each Existing Owner shall be deemed to have submitted Sell Orders with respect to all of its Bonds for which there is to be a change in the length of the Auction Period except to the extent such Existing Owner submits an Order with respect to such Bonds. If the condition referred to above is not met, the Auction Rate for the next Auction Period shall be the Maximum ARS Rate and the Auction Period shall be a seven-day Auction Period.

(iii) On the conversion date for ARS Bonds from one Auction Period to another, any Bonds which are not the subject of a specific Hold Order or Bid shall be deemed to be subject to a Sell Order.

(b) Changes in Auction Date.

During any ARS Rate Period, the Auction Agent, with the written consent of the Board, may specify an Auction Date for Bonds other than the Auction Date that would otherwise be determined in accordance with the definition of "Auction Date." The Auction Agent shall provide notice of its determination to specify an earlier Auction Date for an Auction Period by means of a written notice delivered at least 45 days prior to the proposed changed Auction Date to the Trustee, the Board, the Bond Insurer, the Broker-Dealers and the Securities Depository.

Conversions from ARS Rate Periods.

Subject to the restrictions set forth in the Indenture, at the option of the Board, all or any portion of any Subseries of ARS Bonds may be converted from an Auction Rate Mode to a Weekly Mode, a

Flexible Mode, a Term Rate Mode or a Fixed Rate Mode, provided that after any partial conversion there are no less than \$10,000,000 of any series of ARS Bonds outstanding, bearing interest at an ARS Rate, unless consented to by all Broker-Dealers, as follows:

(i) If any of the ARS Bonds are in an Auction Period, the Adjustment Date to a Weekly Rate or a Flexible Rate will be the second regularly scheduled Interest Payment Date following the final Auction Date; provided, however, that in the case of a Special Auction Period, the Adjustment Date to a Weekly Rate or Flexible Rate will be the Interest Payment Date immediately following the last day of the Special Auction Period.

(ii) The Board will give written notice of any such conversion to the Bond Insurer, the Trustee, the Auction Agent, the Remarketing Agent, if any, and the Broker-Dealer not less than five (5) Business Days prior to the date on which the Trustee is required to notify the Owners of the conversion pursuant to subparagraph (iii) below. Together with such notice, the Board will file with the Bond Insurer and the Trustee an Opinion of Bond Counsel to the effect that the conversion of the ARS Bonds to a Weekly Mode or a Flexible Mode, including the assignment of maturity dates and sinking fund payment dates, will not adversely affect the validity of the ARS Bonds or any exemption from federal income taxation to which interest on the ARS Bonds would otherwise be entitled. No change to a Weekly Mode or a Flexible Mode will become effective unless the Board will also file with, the Bond Insurer and the Trustee, such an opinion dated the applicable Adjustment Date, as the case may be.

(iii) Not less than fifteen (15) days prior to the Adjustment Date for conversion to the Weekly Mode or Flexible Mode, the Trustee or the Trustee's Agent will mail a written notice of the conversion to the Owners of all ARS Bonds to be converted, specifying the Adjustment Date and setting forth the matters required to be stated pursuant to the Indenture with respect to purchases of the ARS Bonds.

(iv) If on an Adjustment Date from the Auction Rate Mode any condition precedent to such conversion required under the Indenture is not satisfied, the Trustee will give written notice by first class mail postage prepaid as soon as practicable and in any event not later than the next succeeding Business Day to the ARS Bondholders, the Board and the Bond Insurer that such conversion has not occurred, that the ARS Bonds will not be purchased on the failed Adjustment Date, that the Auction Agent will continue to implement the Auction Procedures on the Auction Dates with respect to the ARS Bonds which otherwise would have been converted excluding however, the Auction Date falling on the Business Day next preceding the failed Adjustment Date, and that the interest rate will continue to be the ARS Rate; provided, however, that the interest rate borne by the ARS Bonds during the Auction Period commencing on such failed Adjustment Date will be the Maximum ARS Rate and the Auction Period will be the seven-day Auction Period.

In addition, all or a portion of the ARS Bonds may be converted to a Fixed Mode pursuant to the terms of the Indenture.

If a Statutory Maximum Rate Failed Auction shall occur and each Auction held during the succeeding 105 days shall also be a Statutory Maximum Rate Failed Auction (a "Conversion Trigger Event"), the Board covenants thereafter to use all reasonable efforts to convert the interest rate on the Bonds to another Interest Mode in accordance with the Indenture, to the extent such conversion can be accomplished in accordance with the laws of the State (including the Statutory Maximum Rate) on reasonable and customary terms; provided, however, that any such conversion shall be subject to the Board obtaining, if necessary, a Liquidity Facility having reasonable and customary terms and provisions. On each Auction Date following a Conversion Trigger Event and prior to the conversion of interest rate on the Bonds to another the Interest Mode as provided herein, the Auction Agent shall continue to conduct Auctions in accordance with the Auction Procedures. If any Auction so held shall not be a Statutory Maximum Rate Failed Auction, the Board shall have no continuing obligation to convert the

interest rate on the Bonds to another Interest Mode. If each such Auction shall be a Statutory Maximum Rate Failed Auction, the Board shall continue to use all reasonable efforts to convert the interest rate on the Bonds to another Interest Mode.

Auction Agent

Auction Agent.

(a) The Auction Agent will be appointed by the Trustee at the written direction of the Board with the consent of the Bond Insurer to perform the functions specified in the Indenture. The Auction Agent will designate its Principal Office and signify its acceptance of the duties and obligations imposed upon it in the Indenture by a written instrument, delivered to the Board, the Trustee and each Broker-Dealer which will set forth such procedural and other matters relating to the implementation of the Auction Procedures as will be satisfactory to the Board and the Trustee.

(b) Subject to any applicable governmental restrictions, the Auction Agent may be or become the owner of or trade in the ARS Bonds with the same rights as if such entity were not the Auction Agent.

Qualifications of Auction Agent; Resignation; Removal.

The Auction Agent will be (a) a bank or trust company organized under the laws of the United States or any state or territory thereof having a combined capital stock, surplus and undivided profits of at least \$30,000,000, or (b) a member of NASD having a capitalization of at least \$30,000,000 and, in either case, authorized by law to perform all the duties imposed upon it by the Indenture and a member of or a participant in, the Securities Depository. The Auction Agent may at any time resign and be discharged of the duties and obligations imposed upon it by the Indenture by giving at least ninety (90) days notice to the Board, the Bond Insurer and the Trustee (who shall give notice of the same to each Broker-Dealer). The Board may remove the Auction Agent by giving at least fifteen (15) days' notice to the Auction Agent, the Bond Insurer and the Trustee (who shall give notice of the same to each Broker-Dealer). The resignation or removal of the Auction Agent pursuant to the preceding two sentences shall take effect upon the day specified in the notice provided by the Auction Agent or the Board but only if a successor shall have been appointed by the Board in accordance with the requirements of this section, in which event such resignation shall take effect immediately on the appointment of such successor whether or not the date specified for such resignation to take effect has arrived. In the event that the Auction Agent has not been compensated for its services, the Auction Agent may resign, provided that notice and an opportunity to cure has been given to the Bond Insurer at least forty-five (45) prior to the proposed resignation date, by giving at least sixty (60) days' notice in writing to the Board, the Bond Insurer and the Trustee (who shall give notice of the same to each Broker-Dealer), and upon expiration of such 60 days, the Auction Agent may resign even if a successor Auction Agent has not been appointed. Upon any resignation or removal of the Auction Agent, the Board shall appoint a successor Auction Agent meeting the requirements of this section, subject to receipt of Bond Insurer Approval, which Bond Insurer Approval shall not be unreasonably withheld. The Board shall provide the Bond Insurer with written notice of the identity of the substitute Auction Agent to be appointed and the date such appointment is scheduled to take effect not less than seven (7) days prior to such scheduled effective date. If the Bond Insurer shall fail to object in writing to the appointment of a substitute Bond Insurer prior to the effective date identified in the notice delivered by the Board, the Bond Insurer shall be deemed to have consented to such appointment. In the event of the resignation or removal of the Auction Agent, the Auction Agent will pay over, assign and deliver any moneys and the ARS Bonds held by it in such capacity to its successor. The Auction Agent will continue to perform its duties until its successor has been appointed by the Board.

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