



**ANNUAL STOCKHOLDERS' REPORT
FISCAL YEAR 2007-2008
&
NOTICE OF THE
ANNUAL STOCKHOLDERS' MEETING
FEBRUARY 18, 2009**



****IMPORTANT INFORMATION****

Chloramines:

Valencia Heights Water Company (VHWC) primarily uses chlorine for water disinfection purposes. As a result of varying water sources and disinfection methods, on occasion, the water is disinfected by the use of chloramines, which is a combination of chlorine and ammonia. While chloramines serve the same purpose as chlorine, the by-product (chloraminated water) cannot be used with the following:

- Dialysis equipment, and
- Exotic fish ponds

Please be advised that if this describes your situation, please contact us at:

Valencia Heights Water Company

3009 East Virginia Avenue

West Covina, CA 91791-2252

Phone: (626) 332-8935 or (626) 332-3577

Fax: (626) 332-9441

Website: vhwc.org

Email: info@vhwc.org

Office Hours:

Monday – Thursday 8 a.m. to 6 p.m.

Fridays CLOSED

Billing and Payments:

- Water bills are mailed near or on the fifth (5th) of every month.
- **Water bill payments are to be received by the 25th of every month.**
- Past Due notices are mailed in envelopes on the next business day after the 25th of every month.
- We only accept bank, cashier, personal checks, money orders, and cash.

For your convenience, payments can be left at our office during regular business hours, or you can use the front door mail slot to drop payments after hours and holidays.

If you are unable to make your payment by the 25th, then to prevent a \$30 late fee, please call the office to set-up a payment arrangement.

***PLEASE SIGN PROXY CARD
REMOVE AND MAIL***



ANNUAL STOCKHOLDERS' MEETING

Day: Wednesday

Date: February 18, 2009

Time: 7:00 p.m.

Location: South Hills High School
645 S. Barranca St.
West Covina, CA 91791

Faculty Dining Room

Your Attendance is Appreciated!

VALENCIA HEIGHTS WATER COMPANY

Annual Stockholders' Meeting

Wednesday, February 18, 2009

7:00 p.m.

AGENDA

1. Open Meeting
2. General Manager's Report
 - a. Water Supply
 - b. Capital Projects
 - c. Water Quality
3. Water Rates
4. Report for a Quorum
5. Call To Order
6. Approval of Minutes of February 20, 2008
7. Approval of Financial Statements
8. Amendment to the Bylaws
9. Election of Directors
10. Discussions, Questions and Answers
11. Other Business
12. Motion to Adjourn

PLEASE SIGN THE ENCLOSED PROXY CARD and return it as soon as possible with your vote indicated. This allows the required business of the Company to be properly conducted. Should you attend the meeting, you may vote in person.

The Board of Directors and Management solicit your affirmative proxy vote for any and all matters presented at the Annual Meeting for approval.

The Board of Directors proposed for election is as follows:

Curtis Feese	Incumbent/Attorney S.C. Gas, Retired
Eugene Jacobs	Incumbent/General Contractor
Guy Kinsman, Jr.	Incumbent/Consultant
Daniel Liese	Incumbent/Owner-Director/of AEPC Group, LLC
Wayne Partee	Incumbent/Pres./CEO of Partee Insurance Associates, Inc.
Norman Richman	Incumbent/Engineering Consultant
Ronald Wheeler	Incumbent/Facilities Manager, MWD of So. California

PLEASE SIGN THE PROXY CARD EXACTLY AS YOUR NAME(S) APPEAR(S) ON THE CARD.

IF STOCK IS JOINTLY HELD, THEN ALL OWNERS MUST SIGN THE PROXY CARD.

****PLEASE RETURN SIGNED PROXY CARD**
BY FEBRUARY 13, 2009**

VALENCIA HEIGHTS WATER COMPANY

Annual Shareholders' Meeting

Minutes of February 20, 2008

Board: C. Feese, G. Jacobs, G. Kinsman, Jr., D. Liese, W. Partee,
N. Richman,

Staff: D. Michalko, B. Karady, G. Galindo, A. Galindo

Others: A. Schultheiss, E. Schultheiss, R. Blanton, B. Hansen, K. McCann,
R. Molina, D. Minto, R. Newton, W. Berger, D. Hicks

1. Open Meeting

The Chairman called the meeting to order at 7:05 p.m., welcomed everyone and introduced the Board of Directors.

2. General Manager's Report

a. Water Supply

The General Manager reported on supply issues; such as, the Delta flows, 1 local rainfall and record-low ground water levels.

b. Capital Projects

The General Manager reported on the drilling and construction of Well No. 7. The General Manager explained the importance of the assessment that pays for large capital projects; such as, Well No. 7.

c. Water Quality

The General Manager reported on the new MCL for perchlorate.

3. Report for a Quorum

G. Galindo reported that a quorum was present:

2410 Shares Outstanding

1206 Shares Required for a Quorum

1933 Shares Present and/or Voting

- Motion by W. Berger and second by R. Molina to accept the count as presented by staff.

Proxy Vote

For	1759
Against	42
Abstain	132

4. Call to Order

7:35 p.m.

Annual Stockholders' Meeting Minutes

February 20, 2008

Page 2

5. Approval of Minutes of February 22, 2007
 - Motion by R. Molina, Second by K. McCann to approve the minutes as presented. Motion Carried.
6. Approval of the Financial Statements

The Treasurer reported on the financial position of the Company.

 - Motion by W. Berger, Second by K. McCann to approve the financial statements of the Company year-end October 31, 2007. Motion carried.
7. Amendment to the By-laws

The Board addressed the purpose of this amendment and assured the stockholders of the benefits.

 - Motion by D. Minto, Second by W. Berger. Motion carried.
8. Election of Directors
 - a. Board Vacancy

The Chairman announced that C. Thompson had resigned. The Chairman and General Manager thanked C. Thompson for her many years of service and dedication to the Company.

 - Motion by W. Berger, Second by D. Minto to re-elect the Board as presented at the meeting. Motion carried.
9. Discussions, Questions and Answers

No further discussion took place. The Board thanked everyone for coming and noted that the meeting was very productive.
11. Other Business

None
12. Motion to Adjourn

The meeting was adjourned at 8:05 p.m.

Respectively Submitted,

Wayne Partee, Secretary

AMENDMENTS to the COMPANY BY-LAWS

This year's Annual Report includes two (2) proposed By-law Amendments. The Board of Directors, at Valencia Heights Water Company (VHWC), requests that each stockholder review and consider the approval of each. The Board asks that you please support these amendments to achieve the goals of the Company.

Amendment #1, Article X, Section 1

This amendment coincides with amendments that were approved in 1991 and 1996, with regard to non-appurtenant shares becoming appurtenant, and the issuing of only appurtenant shares per the California Department of Corporations. This is merely a clarification change since once stock becomes appurtenant to the property, a stockholder and the property owner are one-in-the-same.

ARTICLE X – SHARE OWNERSHIP AND ASSESSMENT

Section 1. STOCK APPURTENANT TO CERTAIN LANDS. All capital stock of this Corporation issued after January 2, 1991 except for (i) any share certificates issued to replace share certificates originally issued before January 2, 1991, which has been reissued as a result of the sale of excess shares and all shares issued with respect to Tract No. 31666 to which the Corporation provides water service through the County Waterworks District, is appurtenant to the real property owned by the Corporation shareholders

In accordance with the requirement of Section 2 of this Article X, e~~Each shareholder~~ property owner within the Corporation's service area (as defined in Article 1, Section 3, of these Bylaws) must have one share of stock for the first 28,500 square feet of property. For property larger than 28,500 square feet, two (2) shares of stock are required regardless of the size of the property served or serviced with water by the Corporation, or which is owned, held or occupied by the ~~shareholder~~ property owner in connection with land served or serviced with water irrespective of whether such land is water or irrigated. Water shall be available to such property as provided in Article XI, Section 3. Each property owner entitled to water service from the Corporation ~~shareholder~~ may have only one meter installed for each recorded lot owned by that person or entity ~~shareholder~~ except for multi-family dwellings. In addition, a ~~shareholder~~ property owner must own at least one share of stock for each meter. Any fractional shares that would be issued under the area requirements above, shall be rounded up to the nearest whole share. Each certificate issued shall describe on its face the particular real property to which the shares represented by that certificate are appurtenant.

Amendment #2, Article XI, Section 5

This amendment is an addition to Section 5. The amendment does not add any additional powers to the Board or the Company, but helps to clarify and alert the stockholder about how critical the current water supply storage has become. The goal of the Board is to increase conservation by curtailing waste and not restricting water needs.

ARTICLE XI - WATER DELIVERY

Section 5. FURTHER CHARGES. Should any stockholder desire water in such quantities or under such pressures as may result, in the sole and conclusive judgment of the Board of Directors, in an inadequate water supply or pressure to any other stockholder or stockholders, or require additional outlay of capital or increase operating expense, the Board of Directors shall place such reasonable charges, conditions and/or restrictions on said stockholder as will compensate the Company for/or prevent such result, and should said stockholder fail or refuse to comply with said charges, conditions and restrictions, the Board of Directors shall deny the service desired by said stockholder to the extent that it causes the result heretofore mentioned.

If the Board of Directors determines a water shortage or drought exists that adversely impacts the Company's ability to obtain water supplies necessary to provide service to the Company's shareholders and customers, the Board of Directors may declare a water shortage within the area serviced by the Company. If such a declaration is made, the Company may enact a Water Conservation and Rationing Plan, which may include, but not be limited to, charges to provide incentive for the reduction of water use; fines to penalize excessive water use or waste; and water restriction measures. If that plan does not prove to be successful, the Board of Directors may thereafter take whatever steps in accordance with California law that it deems reasonably necessary to continue the Company's ability to provide water service.

GENERAL MANAGER'S REPORT

With another challenging year behind us, and new challenges ahead, please take this opportunity to review the following pages and become informed about what **your water company** is doing to meet your ongoing water needs, and how you can help.

Currently, the greatest challenge facing Valencia Heights Water Company (VHWC) is the lack of a local water supply which is due to a regional drought, and continued restrictions placed on the Sacramento/San Joaquin River Delta by Federal Court decisions. Some of the other issues addressed in this report are the Water System Capital Improvements, the new Well No. 7, Water Quality, and a Restructured Water Rate Schedule.

Water Supplies

During the past year, the water table in the Main San Gabriel Basin (the Basin) has continued to drop. This is the result of eight (8) of the last ten (10) years of rainfall having been below normal with two (2) of those eight (8) years being historically dry years. California, along with the entire western United States, continues to face an extended period of drought that has reduced and now eliminated the availability of import water to recharge or refill the ground water basin in the San Gabriel Valley.

As of November 2008, the groundwater level was at 201 feet above mean sea level and only six (6) feet above the historic low. The operating range for the Basin is 200 feet to 250 feet. The result of this drop is less water availability and a greater cost to pump the water out of the ground. Regardless of the amount of rainfall received locally this year, the level is expected to continue dropping well below the historic low of 195 feet that was reached back in 1991.

Some of the ideas developed to address the shortage of local water, and the lack of recharge water are:

- Reduce Water Demand – Conservation
- Reduce Ground Water Pumping
- Develop Additional Sources of Recharge Water
- Water Rates

The first step, in order to make it through this dry time, is for all consumers to reduce water use as much as possible. Your Company would like to see a minimum 10% reduction now, with a 20% goal by summertime. **If water supplies continue to fall, Governmental Agencies will be mandating a 20% reduction.** Most reduction goals can be achieved by reducing water waste in such areas as; landscape irrigation, irrigation overspray on driveways and

sidewalks, washing off driveways and sidewalks, and by repairing leaks and drips around the yard and home.

Some of the ways to achieve the goals the Company is asking for are to, only water during night or morning hours before sunrise, and when there is no wind. During the cool months, reduce or shut off sprinklers, and in the summer months avoid watering everyday, remembering that 70% of your water is used outdoors. These steps will make the greatest impact on water savings. In addition, the Company asks that you do not wash down driveways and sidewalks. Many cities and water agencies are already issuing fines to people who do not comply with this mandated restriction. Those of you who live within the unincorporated area of Los Angeles County should be aware of recent developments. As of October 7, 2008 the County adopted an ordinance that prohibits wasteful water use as previously discussed in this report. If a County Enforcement Officer observes water waste you could be fined \$100. If you would like a copy of the Ordinance please go to vhwc.org and click on the County link or contact the office. Finally, leaks and drips continue to build hour-after-hour and day-after-day. If you need assistance in locating any leaks, or determining if you may have a leak, please do not hesitate to contact the office and we will provide you with assistance and/or guidance as is necessary.

Making these changes in your water use can make great strides in savings, and prevent or at least delay the need for **water rationing**. The Company hopes to prevent the need for **mandatory water rationing**, but this will depend upon everyone's effort and cooperation to reduce waste and unnecessary water use. In addition, please spend some time at bewaterwise.com, mwdh2o.com, and watch the PBS stations. They have some great conservation tips and informative programs sponsored by the California Water Agencies. You can also visit vhwc.org for more links to help with your conservation.

The second idea that groundwater producers are currently working on is shifting production from groundwater to Metropolitan Water District (MWD) treated water supplies. This plan coincides with groundwater levels. As the Basin continues to drop, the producers have developed plans to reduce groundwater production in proportion to Basin water levels. As the Basin reaches the record-low of 195 feet, 10% of groundwater production will be shifted to purchased MWD treated water supplies. If groundwater levels continue to drop and reach the 180 foot mark, 20% of groundwater production will be shifted to purchased MWD treated water supplies. While this sounds simple, this shift does not come without a cost. This shift from groundwater pumping to MWD purchases will result in a significantly higher cost for water. So again, we must seriously practice **CONSERVATION**.

Another alternative that the Basin managers and producers are developing is the design and construction of a 10,000 to 25,000 acre foot per year treatment plant to treat recycled water to a high quality water, using advanced treatment technologies. This water would be used for Basin recharge and would be enough water for more than 35,000 homes. This process has been in use in Orange County for over a year now and is proving very successful. The advanced treatment process includes Microfiltration, Reverse Osmosis, and Ultraviolet Light with Hydrogen Peroxide (UV).

The Microfiltration Process uses recycled water that already meets drinking water standards. This step removes virtually all traces of bacteria, protozoa and viruses. The Reverse Osmosis process provides additional filtration to insure removal of any remaining bacteria and other impurities. The final process, UV, removes and destroys disinfection by-products and renders the treated water completely sterilized. The sterilized water would then be pumped to the Santa Fe Dam and the sterilized water will be recharged back into the groundwater basin. This water is essential to sustain a reliable water supply for the San Gabriel Valley. In addition, this sterilized water will always be available, would be under local control, and will not be subject to drought or cut-backs.

Well No. 7

In February of 2008, the Company began the process of constructing a new water well, Well No. 7. After more than 2 1/2 years of working with the Los Angeles County Flood Control, the City of West Covina, and the California Department of Public Health (CDPH), the drilling process began on March 12, 2008. The new well was drilled to a depth of 760 feet. With more than 50% of the water coming into the well, between 650 feet and 750 feet of depth, the Company does not expect to have any problems with water quality. Upon completion of the drilling and construction, a test pump was installed to develop and determine the quantity of water (the safe yield) available from the well. The Company was very pleased that after only one (1) week of development, the well far exceeded our expectations. The new well is capable of producing 1500 gallons per minute. Once the development was completed, the Company began the permitting and approval process of this water source with CDPH. The final approval and installation of the pump and electrical equipment is expected in early 2009, with the well being ready for production as water demands increase in late Spring and early Summer of this year.

Other Capital Projects

During the past year, the Company has been installing additional fire hydrants in the high fire-prone areas of the water system. These hydrants have been, and will continue to be, installed at the locations

suggested by the Los Angeles County Fire Department (LACFD) which will best suit their needs to protect your homes. While the Company continues to work with LACFD to enhance water availability, the fire department cannot protect your home without proper brush clearance and access. The LACFD has repeated over and over again that no amount of water will save your home if there is not proper clearance and access. Please make every effort to help the fire department in their effort to protect your property and home by providing proper brush clearance. During the past year, five (5) hydrants were installed with four (4) additional hydrants to be installed shortly. Other small projects have included 600 feet of 8 inch waterline on Limecrest, and 250 feet of waterline on North Cameron Avenue. Future projects are shown on the Company's 5 - Year Capital Improvement Plan on Page 13.

Water Quality

There have been no significant changes in water quality issues this past year. However, as the water table continues to drop, we continue to be diligent in our monitoring activities to be prepared for any changes which may occur. We have seen minor increases in nitrate and perchlorate levels in our wells, along with the Covina Irrigating Company (CIC) wells. We receive approximately half of our water from CIC, however, most of our entitlement from CIC comes from treated surface water supplies from the San Gabriel River. This is very high quality water which we blend with our own well water to improve the overall water quality. However, with a reduction of local rainfall, there may be less treatment plant water available, resulting in a shift to CIC groundwater wells which are showing the slight increase in contaminate levels. Even with these operational challenges, the Company will continue to provide you with clean, safe and the most cost-effective water that it can supply.

Rates and Conservation

For more than 15 years, Valencia Heights Water Company has been one of the few water companies in the San Gabriel Valley to encourage conservation by having a three tier water rate structure. Such conservation rates are now becoming the standard, and are also required by the Public Utilities Commission. During the past year, the Board has reevaluated the water rate structure. To assist with the evaluation, the Board decided to have an outside firm evaluate our rate structure and make recommendations based on operational costs, reserve funding and water availability. The results of the study are reflected in the new rate structure. The new rate structure the Board is implementing will become effective on March 1, 2009, and takes into account; lot size, meter size, and stock ownership. The new rates also reflect a 3 cent per unit increase to the base rate, approved by the Board on January 20, 2009.

The purposes of this new rate structure are twofold:

- To have the consumer that uses the most water, pay their fair share.
- To promote increased water conservation.

The new rate structure is detailed in the enclosed flyer. With these changes in place, the Company can achieve its financial goals, and still provide a **very cost-effective** service to our customers. The Company will dedicate as much time as is necessary to explain the new rate structure, how it affects your bill, and how it compares to the surrounding area. After an extensive review, your water company's water rates will still be one of the lowest water rates in the San Gabriel Valley.

In closing, I would like to once again thank the Board of Directors for the opportunity provided me to lead Valencia Heights Water Company in obtaining the goals of the Company, and be able to continue providing clean, safe water at the best possible value. As a Stockholder in the Company, you can be assured that each decision made by the Board is made with the best interest of you, the Stockholder in mind. Also, I would like to thank the staff for their support. Without this dedicated and professional staff, I would not be able to report on the continued success of the Company, year after year.

As in past years, the pages following this report contain the last 2 years of audited financial statements. If you have any questions regarding the financial statements, this report or anything else regarding water, please bring them to the **Annual Meeting on February 18, 2009**. The meeting will be held at the same location as last year in the Faculty Dining Room, at South Hills High School. We look forward to your participation at the meeting. The Dining Room is located on the north side of the campus near the parking lot. There will be signs posted.

*Sincerely,
Dave Michalko
General Manager*

CAPITAL IMPROVEMENT PROJECTS

2008-2012

2009

Complete Well No. 7	\$	200,000
Well No. 2 and 3a Destruction	\$	50,000
Office Site Work	\$	10,000
SCADA Work	\$	125,000
Fire Hydrant Work	\$	15,000
Miscellaneous System Work/Rate Study	\$	25,000
Total	\$	425,000

2010

Miscellaneous Paving at Sites	\$	25,000
Reservoir Rehabilitation	\$	125,000
Miscellaneous System Work	\$	10,000
Total	\$	160,000

2011

Pump Station No. 2 Upgrade	\$	200,000
Miscellaneous System Work	\$	10,000
Total	\$	210,000

2012

Cortez Waterline Work (2800-2900 block)	\$	75,000
Service Truck Replacement	\$	35,000
Reservoir Rehabilitation	\$	100,000
Miscellaneous System Work	\$	10,000
Total	\$	220,000

2013

Parkview Water Line (under freeway)	\$	75,000
Reservoir No.1 to Reservoir No.2 Line	\$	200,000
Miscellaneous System Work	\$	10,000
Total	\$	285,000

Estimated Cost Over 5 Years	\$	1,300,000
Average Cost Per Year	\$	260,000

Additional/Future Projects

Golden Bough Line
 Buenos Aires Line to Limecrest to Damerl
 Truck Replacement
 Potential Treatment Facility/Softening
 6" Line at end of Buenos Aires
 Service Line Replacements (System Wide)
 Buenos Aires and Lorencita Lines

* Emergency Portable Generator and Set-up
 Cameron and Grand Crossing
 Reservoir Resurfacing
 Additional Waterline Replacements



INDEPENDENT AUDITORS' REPORT

Board of Directors
Valencia Heights Water Company
West Covina, California

We have audited the balance sheets of Valencia Heights Water Company as of October 31, 2008 and 2007, and the related statements of operations, changes in members' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Valencia Heights Water Company as of October 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Vicenti Lloyd + Stutzman LLP
VICENTI, LLOYD & STUTZMAN LLP

November 20, 2008

2210 E. Route 66, Suite 100, Glendora, CA 91740

Tel **626.857.7300** | Fax **626.857.7302** | E-Mail **INFO@VLSLLP.COM** | Web **WWW.VLSLLP.COM**

VALENCIA HEIGHTS WATER COMPANY

West Covina, California

Los Angeles County

BOARD OF DIRECTORS

<u>MEMBER</u>	<u>OFFICE</u>	<u>TERM EXPIRES</u>
Wayne Partee	Chairman	February 18, 2009
Daniel C. Liese	Vice Chairman	February 18, 2009
Guy Kinsman, Jr.	Secretary	February 18, 2009
Curtis Feese	Treasurer	February 18, 2009
Eugene Jacobs	Director	February 18, 2009
Norman Richman	Director	February 18, 2009
Ronald Wheeler	Director	February 18, 2009

ADMINISTRATION

David Michalko, General Manager

Barbara Karady, Executive Administrator

STAFF

Gloria Galindo, Customer Support/Accounting Clerk

Steve Gonzalez, Water Tech I

Rudy Olivarez, Water Tech I

Tim Pacheco, Water System Supervisor

Eunice White, Account Receivable

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

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VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

BALANCE SHEETS
October 31, 2008 and 2007

ASSETS

	<u>2008</u>	<u>2007</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 315,641	\$ 360,147
Investments	687,458	500,656
Accounts receivable	269,960	215,449
Inventory	26,355	28,197
Prepaid expenses	44,853	61,637
Leased water rights	-	95,130
Current portion of note receivable	<u>48,942</u>	<u>47,300</u>
Total current assets	<u>1,393,209</u>	<u>1,308,516</u>
PROPERTY, PLANT & EQUIPMENT (net)	<u>4,654,789</u>	<u>4,838,918</u>
OTHER ASSETS		
Construction in progress	501,022	16,195
Reserve - Walnut Valley	6,250	6,250
Shares of Covina Irrigating Company	738,890	738,890
Deferred compensation	56,739	74,488
Water rights	720,000	720,000
Note receivable, net of current portion	<u>923,293</u>	<u>972,228</u>
Total other assets	<u>2,946,194</u>	<u>2,528,051</u>
TOTAL ASSETS	<u><u>\$ 8,994,192</u></u>	<u><u>\$ 8,675,485</u></u>

See independent auditor's report and accompanying notes to financial statements.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

BALANCE SHEETS
October 31, 2008 and 2007

LIABILITIES AND MEMBERS' EQUITY

	<u>2008</u>	<u>2007</u>
CURRENT LIABILITIES		
Accounts payable	\$ 81,968	\$ 36,274
Property taxes payable	30,467	27,665
Current portion of note payable	21,557	20,626
Leased water rights	-	95,130
Income taxes payable	<u>42</u>	<u>353</u>
Total current liabilities	<u>134,034</u>	<u>180,048</u>
LONG-TERM LIABILITIES		
Note payable, net of current portion	227,339	248,897
Deferred compensation	<u>56,739</u>	<u>74,488</u>
Total long-term liabilities	<u>284,078</u>	<u>323,385</u>
Total liabilities	<u>418,112</u>	<u>503,433</u>
MEMBERS' EQUITY		
Contributions in aid of construction	1,854,545	1,929,328
Common stock - 10,000 shares authorized; \$100 par value; 1,191 and 1,205 shares issued and outstanding as of October 31, 2008 and 2007, respectively	119,100	120,500
Class A common stock - 10,000 shares authorized; \$100 par value; 1,226 and 1,205 shares issued and outstanding as of October 31, 2008 and 2007, respectively	122,600	120,500
Additional paid-in capital	669,511	622,011
Retained earnings	<u>5,810,324</u>	<u>5,379,713</u>
Total members' equity	<u>8,576,080</u>	<u>8,172,052</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 8,994,192</u>	<u>\$ 8,675,485</u>

See independent auditor's report and accompanying notes to financial statements.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

STATEMENTS OF OPERATIONS
For the Years Ended October 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES		
Water sales and services	\$ 1,771,887	\$ 1,835,292
Assessments	279,032	191,051
Connection charges	<u>107,100</u>	<u>-</u>
Total operating revenues	<u>2,158,019</u>	<u>2,026,343</u>
OPERATING EXPENSES		
Purchased water	326,580	208,006
Purchased power	229,772	241,650
Leased water rights expense	150,743	123,589
Operations	40,982	37,279
Water testing	8,362	4,989
Vehicle expense	23,485	14,302
Repairs and maintenance	<u>42,775</u>	<u>75,033</u>
Total transmission and distribution expenses	<u>822,699</u>	<u>704,848</u>
GENERAL AND ADMINISTRATIVE EXPENSES		
Salaries and benefits	461,446	457,761
Directors' fees	27,500	27,300
Legal and accounting	20,563	30,913
Office expenses and utilities	64,420	55,878
Insurance	34,763	47,954
Taxes and licenses	120,775	112,523
Assessments	57,018	52,560
Depreciation	<u>180,600</u>	<u>180,432</u>
Total general and administrative expenses	<u>967,085</u>	<u>965,321</u>
INCOME FROM OPERATIONS	<u>368,235</u>	<u>356,174</u>
OTHER INCOME (EXPENSE)		
Interest income	77,358	54,013
Interest expense	(11,813)	(12,704)
Other income	<u>4,713</u>	<u>15,374</u>
Total other income	<u>70,258</u>	<u>56,683</u>
INCOME BEFORE TAXES	438,493	412,857
PROVISION FOR INCOME TAXES	<u>7,882</u>	<u>7,833</u>
NET INCOME	<u>\$ 430,611</u>	<u>\$ 405,024</u>

See independent auditor's report and accompanying notes to financial statements.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

STATEMENTS OF CHANGES IN MEMBERS' EQUITY
For the Years Ended October 31, 2008 and 2007

	Number of Shares	Common Stock	Contributions in Aid of Construction	Additional Paid-in Capital	Retained Earnings	Total
Balance - October 31, 2006	2,424	\$ 242,400	\$ 1,517,868	\$ 622,011	\$ 4,974,689	\$ 7,356,968
Net income					405,024	405,024
Contributions			473,738			473,738
Stock cancelled	(14)	(1,400)				(1,400)
Amortization			(62,278)			(62,278)
Balance - October 31, 2007	2,410	241,000	1,929,328	622,011	5,379,713	8,172,052
Net income					430,611	430,611
Contributions						-
Stock issued	8	800		47,400		48,200
Stock cancelled	(1)	(100)		100		-
Amortization			(74,783)			(74,783)
Balance - October 31, 2008	<u>2,417</u>	<u>\$ 241,700</u>	<u>\$ 1,854,545</u>	<u>\$ 669,511</u>	<u>\$ 5,810,324</u>	<u>\$ 8,576,080</u>

See independent auditor's report and accompanying notes to financial statements.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

STATEMENTS OF CASH FLOWS
For the Years Ended October 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 430,611	\$ 405,024
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	180,600	180,432
(Increase) decrease in operating assets:		
Accounts receivable	(54,511)	(42,748)
Inventory	1,842	2,467
Prepaid expenses	16,784	(3,799)
Bond for road repair	-	10,109
Increase (decrease) in operating liabilities:		
Accounts payable	45,695	(24,058)
Property taxes payable	2,802	2,077
Leased water rights	-	(2,399)
Income taxes payable	<u>(311)</u>	<u>341</u>
Net cash provided by operating activities	<u>623,512</u>	<u>527,446</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(6,188)	(11,952)
Capital expenditures for construction in progress	(549,895)	(79,767)
Principal proceeds from installment sale of land	47,293	50,189
Purchases of investments	<u>(186,802)</u>	<u>(451,943)</u>
Net cash used by investing activities	<u>(695,592)</u>	<u>(493,473)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on note payable	(20,626)	(19,734)
Issuance/(redemptions) of stock	<u>48,200</u>	<u>(1,400)</u>
Net cash provided (used) by financing activities	<u>27,574</u>	<u>(21,134)</u>
 NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	 (44,506)	 12,839
 CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	 <u>360,147</u>	 <u>347,308</u>
 CASH AND CASH EQUIVALENTS AT END OF YEAR	 <u>\$ 315,641</u>	 <u>\$ 360,147</u>

See independent auditor's report and accompanying notes to financial statements.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. **Organization**

Valencia Heights Water Company (the Company) is a privately held mutual water company formed to furnish water services for the benefit and use of its members.

B. **Method of Accounting**

Assets, liabilities, revenues and expenses are recorded under the accrual method of accounting. Contributions in aid of construction are recorded when received.

C. **Accounts Receivable**

The Company assesses the need for an allowance for doubtful accounts based upon historical losses and a review of past due accounts at year end. The Company considers accounts receivable to be fully collectible. Accordingly, no allowance for doubtful accounts has been recorded.

D. **Inventory**

Inventory consists primarily of parts and materials used for construction and repair. Inventory is recorded at cost on the first-in, first-out method.

E. **Investments**

The Company considers all certificates of deposit and treasury bills with original maturities of more than three months as investments. All investments owned by the Company are expected to be held to maturity.

F. **Cash and Cash Equivalents**

The Company considers all highly liquid investments with original maturity of three months or less to be cash equivalents.

G. **Contributions in Aid of Construction**

Contributions in aid of construction represent utility plant additions contributed to the Company by property owners or developers desiring services that require capital expenditures or capacity commitments. Decrease in this account represents amortization on those contributed assets.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

H. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain amounts and disclosures. Accordingly, actual results could differ from those estimates.

I. Income Tax

The Company is exempt from Federal income taxes under Section 501(c)(12) of the Internal Revenue Code. However, for state income tax purposes, the Company is taxed only for non-business related income.

J. Concentrations of Credit Risk

The Company maintains its cash and cash equivalent accounts at several financial institutions which are each insured under the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 as of October 31, 2008 and \$100,000 as of October 31, 2007. As of October 31, 2008 there were no uninsured cash balances.

K. Comparative Data and Reclassifications

Comparative total data for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the Company's financial position and operations. Certain reclassifications to prior year comparative amounts have been made in order to be consistent with the current year presentation.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 2 - FIXED ASSETS

Fixed assets consist of property, plant and equipment. They are recorded at cost and currently depreciated over estimated lives ranging from 3 to 40 years using the straight-line method.

Contributed property, plant and equipment are recorded at the cost of property constructed, and are currently amortized over estimated lives ranging from 20 to 40 years using the straight-line method. Amortization is recorded as a reduction of contributions in aid of construction in members' equity.

A summary of property, plant and equipment as of October 31 follows:

	<u>2008</u>	<u>2007</u>
Office equipment and maps	\$ 43,573	\$ 37,386
Machinery, treatment and pumping equipment	796,031	796,031
Buildings and structures	242,779	242,779
Vehicles, tools and equipment	138,861	138,861
Land and land rights	105,374	105,374
Storage tanks and reservoirs	988,297	988,297
Transmission and distribution	4,675,986	4,610,918
Wells	523,104	523,104
SCADA	<u>133,723</u>	<u>133,723</u>
Total property, plant and equipment	7,647,728	7,576,473
Less accumulated depreciation and amortization	<u>(2,992,939)</u>	<u>(2,737,555)</u>
Property, plant and equipment, net	<u>\$ 4,654,789</u>	<u>\$ 4,838,918</u>

NOTE 3 - SHARES OF COVINA IRRIGATING COMPANY

The Company owned 423.25 shares of capital stock of Covina Irrigating Company as of October 31, 2008 and 2007. Shares are carried on the books, at cost. Each share is equal to approximately one acre-foot of water each year.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 4 - RETIREMENT PLAN

The Company sponsors a defined contribution 401(k) pension plan for the benefit of its employees. Company contributions to the Plan for the years ended October 31, 2008 and 2007 were \$22,616 and \$19,872, respectively.

The Company also sponsors a Section 457 deferred compensation plan. There were no contributions to the Plan for the year ended October 31, 2008 or 2007.

NOTE 5 - LINES OF CREDIT

The Company maintained a line of credit with a limit of \$200,000 that was secured by personal property. There was no balance outstanding as of October 31, 2008 and the line of credit was terminated in October of 2008.

NOTE 6 - NOTE PAYABLE

On January 5, 1999, the Company entered into a sublease agreement with Walnut Valley Water District. The capitalized principal balance at October 31, 2008 and 2007 was \$248,897 and \$269,523, respectively. Interest is paid at a rate of 4.47% per year. Principal and interest payments of \$16,219 are due semi-annually, on February 1 and August 1, with a maturity date of February 1, 2018.

The following is a schedule of future combined principal and interest payments for the years ending October 31:

2009	\$ 32,439
2010	32,439
2011	32,439
2012	32,439
2013	32,439
Thereafter	<u>145,971</u>
	308,166
Less interest	<u>(59,270)</u>
	248,896
Less current portion	<u>(21,557)</u>
Long-term portion	<u>\$ 227,339</u>

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 7 - WATER RIGHTS

In order to stabilize the cost of water, the Company has leased water rights from the stockholders of Covina Irrigating Company. These water rights insure a source of water to supplement the Company's ground water supply and enhance water quality as part of the Company's water supply permit. Leased water rights contracts for the period July 1, 2008 through June 30, 2009 and July 1, 2007 through June 30, 2008 totaled \$222,642 and \$123,589, respectively. Most payments are made on a quarterly basis.

NOTE 8 - NOTE RECEIVABLE

Pursuant to a purchase, exchange and sale agreement signed in March of 2001, the Company received a promissory note from the City of West Covina for the sale of Maverick Field to the City. The note for \$1,215,000 bears interest at a variable rate of 3.09% for the three years ended November 1, 2007, and adjusted to 4.32% for the three years ending November 1, 2010. It is secured by a deed of trust on the land. The sale was consummated when escrow closed in June 2003. Principal and interest are receivable over a twenty-year period. The balance of the note receivable as of October 31, 2008 and 2007 was \$972,228 and \$1,019,528, respectively.

NOTE 9 - COMMON STOCK

The Company has two classifications for its common stock. Class A common stock refers to shares of stock, issued after January 1, 1991, that are appurtenant to a parcel of land. One share of Class A common stock is issued for each parcel of land less than 28,500 square feet. A maximum of two shares is issued to each owner of land exceeding 28,500 square feet. Regular common stock is non-appurtenant to land ownership and was issued prior to 1991.

NOTE 10 - COMPENSATED ABSENCES

Employees of the Company are entitled to paid vacation. Amounts accruable are dependant on length of service and current pay rate. At October 31, 2008 and 2007, the Company had six employees who are entitled to paid vacation. It is not practicable for the Company to continually track the liability, and none has been accrued at year end, as its policy is to recognize the costs of compensated absences when actually paid to employees.

VALENCIA HEIGHTS WATER COMPANY
(A California Mutual Water Company)

NOTES TO FINANCIAL STATEMENTS
October 31, 2008 and 2007

NOTE 11 - SUPPLEMENTAL DISCLOSURES ON CASH FLOWS

	<u>2008</u>	<u>2007</u>
Non-cash investing activities:		
Transferred construction in progress to property, plant and equipment	<u>\$ 65,069</u>	<u>\$ 63,572</u>
Received property, plant and equipment as a contribution in aid of construction	<u>\$ -</u>	<u>\$ 473,738</u>
Cash paid for interest	<u>\$ 11,813</u>	<u>\$ 12,704</u>
Cash paid for income taxes	<u>\$ 8,193</u>	<u>\$ 7,492</u>

VALENCIA HEIGHTS WATER COMPANY

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