

**HARRIS COUNTY
IMPROVEMENT DISTRICT NO. 1**

HOUSTON, TEXAS

FINANCIAL REPORT

June 30, 2009

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Independent Auditors' Report

Board of Directors
Harris County Improvement District No. 1
Houston, Texas

We have audited the accompanying financial statements of the governmental activities and each major fund of Harris County Improvement District No. 1 (the "District"), a component unit of the City of Houston, as of and for the year ended June 30, 2009, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the 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 Harris County Improvement District No. 1, as of June 30, 2009, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and budgetary comparison information are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. The required supplementary information schedules are the responsibility of the District's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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Houston, Texas

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Management's Discussion and Analysis

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

As management of the Harris County Improvement District No. 1, we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2009.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains required supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator regarding the financial position of the District. Other factors that are not included in the financial statements, such as increased tax base in the District's boundaries, should be considered in evaluating the condition of the District's overall financial position.

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

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. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The District maintains three individual governmental funds. Information is presented separately in the *Governmental Fund Balance Sheet* and in the *Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances* for the General Fund, the Debt Service Fund, and the Capital Projects Fund, all of which are considered to be major funds.

Fund financial statements 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. Such information may be useful in evaluating a government's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it may be 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 Fund Balances* provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Government-wide Financial Analysis

In the government-wide statements, the difference between assets and liabilities is called net assets. As previously noted, net assets may serve over time as a useful indicator of a government's financial position. The District's net assets at June 30, 2009, were a negative \$1,765,992. The principal reason for this deficit is the District incurred long-term debt in 1999 to construct approximately \$2 million in infrastructure, which was conveyed to the City of Houston.

Net assets are categorized based on their availability to provide financial resources for the District. Net assets that are "Invested in capital assets, net of related debt" represent the District's investments in capital assets, less any debt used to acquire those assets that is still outstanding. Resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. "Restricted" net assets represent amounts that are restricted for future debt service requirements. "Unrestricted" net assets represent amounts available to meet the District's future obligations.

At year-end, the District had total assets of \$11,216,161. Of this amount, \$5,527,852 consists of cash and investments and \$4,888,696 of capital assets. Total liabilities were \$12,982,156 as of year-end. Of this amount, \$12,100,084 consisted of long-term debt and accrued interest. The remaining balance of the liabilities consists of accounts payable and other accrued liabilities and expenses. A comparative summary of the District's overall financial position, as of June 30, 2009 and 2008, is as follows:

	<u>2009</u>	<u>2008</u>
Current and other assets	\$ 6,327,465	\$ 5,704,212
Capital assets	4,888,696	5,063,966
Total Assets	<u>11,216,161</u>	<u>10,768,178</u>
Other liabilities	1,057,997	1,603,059
Long-term liabilities	11,924,159	12,489,409
Total Liabilities	<u>12,982,156</u>	<u>14,092,468</u>
Net assets:		
Invested in capital assets, net of related debt	(7,456,815)	(7,877,717)
Restricted	1,250,748	1,138,839
Unrestricted	4,440,075	3,414,588
Total Net Assets	<u>\$ (1,765,992)</u>	<u>\$ (3,324,290)</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

Government-wide Financial Analysis (continued)

The total net assets of the District increased by \$1,558,295. A comparative summary of the District's statement of activities for the past two years is as follows:

	<u>2009</u>	<u>2008</u>
Revenues		
Program revenue		
Charges for services	\$ 805,720	\$ 488,478
General revenues		
Property taxes	5,353,982	4,682,064
Unrestricted investment earnings	26,164	166,150
Miscellaneous	379,827	488,844
Total Revenues	<u>6,565,693</u>	<u>5,825,536</u>
Expenses		
General and administrative	1,321,908	1,292,771
Traffic control	1,068,023	1,004,293
Maintenance and beautification	1,373,918	1,171,253
Planning and engineering	74,809	205,318
Marketing and communications	336,858	228,945
Interest on Long-term debt	540,708	546,379
Economic development	108,492	50,245
Construction on behalf of the City of Houston	182,682	1,825,310
Transfers to other governments		
Total Expenses	<u>5,007,398</u>	<u>6,324,514</u>
Increase in net assets	1,558,295	(498,978)
Net assets-beginning	<u>(3,324,287)</u>	<u>(2,825,312)</u>
Net Assets - Ending	<u>\$ (1,765,992)</u>	<u>\$ (3,324,290)</u>

Financial Analysis of the Government's Funds

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the District's governmental funds reported combined ending fund balances of \$5,816,558, an increase of \$1,171,810 in comparison with the prior year. This is due to increased property tax revenues in the operating fund as well as decreased capital spending. The unreserved portion of fund balance is \$4,274,832. This amount is available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed: 1) to fund authorized construction \$145,885 and 2) to pay debt service \$1,349,436.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

Financial Analysis of the Government's Funds (continued)

The following is a summary of changes in fund balances for the prior two fiscal years:

	2009	Increase (Decrease)	2008	Increase (Decrease)	2007
General Fund	\$ 4,321,236	\$ 1,020,531	\$ 3,300,705	\$ 910,721	\$ 2,389,984
Capital Projects Fund	145,885	48,095	97,790	(2,812,965)	2,910,755
Debt Service Fund	1,349,436	103,184	1,246,252	56,825	1,189,427
	<u>\$ 5,816,557</u>	<u>\$ 1,171,810</u>	<u>\$ 4,644,747</u>	<u>\$ (1,845,419)</u>	<u>\$ 6,490,166</u>

The General Fund is the chief operating fund of the District. Fund balance in the General Fund increased by \$1,020,531 during the current fiscal year. This increase is due to positive budget variances in property tax revenues and less planned spending in operational functions. As a measure of the General Fund's liquidity, it may be useful to compare unreserved fund balance to total fund expenditures. At the end of the current fiscal year, the unreserved portion of fund balance of the General Fund was \$4,274,832, while expenditures for the year were \$3,623,679.

The Debt Service Fund has a total fund balance of \$1,349,436, all of which is reserved for the payment of debt service. The increase in fund balance during the current year in the Debt Service Fund was \$103,184.

The Capital Projects Fund has a total fund balance of \$145,885, all of which is reserved for authorized construction. The net decrease in fund balance during the current year in the Capital Projects Fund of \$48,095 is related to final capital expenditures for stainless steel poles, signs, and shields for new planned intersections.

General Fund Budgetary Highlights

The Board of Directors did not amend the budget during the year. The District did not anticipate an increase in the fund balance, while the actual increase was \$1,020,531. Variances between budget and actual were due primarily to positive budget variances in property tax revenues and operational spending.

Debt Administration

At June 30, 2009 and 2008, the District had total bonded debt outstanding as shown below:

Series	2009	2008
Series 1999	\$ 1,575,000	\$ 1,640,000
Series 2004	11,100,000	11,600,000
	<u>\$ 12,675,000</u>	<u>\$ 13,240,000</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

Economic Factors and Next Year's Budgets and Rates

The District is a political subdivision of the State of Texas, created in 1987 by a special act of the 70th Texas Legislature. The District levies an ad valorem tax on real personal property within its boundaries. The tax rate for tax year 2008 was \$0.1435 per \$100 of assessed value. The tax rate will remain the same for tax year 2009, with expected revenues of approximately \$5.06 million.

Office Space

Uptown has over 23 million square feet of office space. In the commercial sector, the vacancy rate has declined from 26 percent to 8.4 percent in the past four years. This achievement, coupled with a steady flow of lease renewals as well as record high rental rates of over \$30 per square foot, speak to the business community's commitment to Uptown and solidify its prominent position as one of the city's most viable economic districts.

Overall, ad valorem values for the office sector increased by 20% in fiscal year 2009 (tax year 2008 vs. 2007). The office market hit some of its highest vacancy rates in 2004 due to the height of the West Loop reconstruction. However, since its completion in 2006 and a tremendous amount of leasing activity occurring in the past four years, the market conditions improved. With the current harsh economic condition, the District is expecting a decline in 2009 office values of approximately 7 percent.

Retail

Uptown is synonymous with shopping and is known as a world-renowned center for retail. Overall, ad valorem values for the retail sector increased approximately 9% in the current fiscal year. This market continues to perform as The Galleria is now the fourth largest retail center in the United States. In early 2008, a 22-acre mixed-use development known as BLVD broke ground in the heart of Uptown. The project will feature over 400,000 square feet of upscale retail stores and restaurants. To date, approximately 70,000 square feet of retail and commercial construction has been completed. Tenants include the acclaimed RDG and Bar Annie restaurant as well as Festari, New Balance and Pickles & Ice Cream.

With the recent national financial crisis, development is expected to slow in the area. The retail values for the District are expected to remain flat for the 2009 tax year.

Hotel

Uptown currently has 30 first quality hotels in the area, offering more than 7,100 rooms for guests. Starwood Hotel & Resorts Worldwide Inc. completed the new 'aloft' hotel. Ad valorem values for this sector increased 18% over last year's values.

The area's RevPAR (revenues per available room) is the highest in the region at \$102.50 compared to \$95.15 for the Houston Central Business District and \$81.66 for Houston City-wide. Uptown Houston had one of the highest occupancy rates in the city at 68%, while the Houston City-wide occupancy rate was 65.1% for the five months ending May 2009. As with the other sectors in the District, hotel ad valorem values are expected to grow moderately at 8% for 2009. However the 2010 values are expected to decline.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2009

Residential

Seven new high-rise residential towers have been built in Uptown in the past eight years and occupancy rates are among the highest in the city at 93%. With more than 30,000 residences, Uptown Houston is one of the most prestigious and desirable areas to live.

The economic and financial stresses that have adversely affected the nation have been slow to affect the Uptown area this reporting period. In fiscal year 2009, the ad valorem values were up 12% over the previous year. However, the ad valorem values for fiscal year ending June 2010 are expected at best to remain flat. As development has slowed down, and the economy remains fragile, District management is forecasting property values to decline in the fiscal year ending June 2011 (i.e. values for tax year 2010 are expected to decline). As such, management is prepared to effectively and efficiently operate programs in a climate of declining values.

Requests for Information This financial report is designed to provide a general overview of the Harris County Improvement District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Harris County Improvement District No. 1, 1980 Post Oak Boulevard #1580, Houston, Texas 77056.

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Basic Financial Statements

HARRIS COUNTY IMPROVEMENT DISTRICT # 1
Statement of Net Assets - Governmental Activities
June 30, 2009

Assets	
Cash	\$ 5,527,852
Investments	
Property taxes receivable	218,838
Due from other governments	517,221
Other receivables	17,149
Prepaid expenses	46,405
Capital assets, net of depreciation	4,888,696
Total Assets	<u>11,216,161</u>
 Liabilities	
Accounts payable and accrued expenses	286,028
Retainage payable	6,044
Accrued interest	175,925
Long term debt	
Due in less than one year	590,000
Due in more than one year	11,924,159
Total liabilities	<u>12,982,156</u>
 Net Assets	
Invested in capital assets, net of related debt	(7,456,815)
Restricted for debt service	1,250,748
Unrestricted	4,440,075
Total net assets	<u>\$ (1,765,992)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT # 1

Statement of Activities - Governmental Activities

For the Year Ended June 30, 2009

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue Charges for Services</u>	<u>Net (Expense) Revenue and Changes in Net Assets</u>
General and administrative	\$ 1,321,908	\$ 471,846	\$ (850,062)
Traffic control	1,068,023		(1,068,023)
Maintenance and beautification	1,373,918		(1,373,918)
Planning and engineering	74,809		(74,809)
Marketing and communications	336,858		(336,858)
Interest on long-term debt	540,708		(540,708)
Economic development	108,492		(108,492)
Construction on behalf of the City of Houston	182,682	333,874	151,192
Total activities	<u>5,007,398</u>	<u>805,720</u>	<u>(4,201,678)</u>
General revenues:			
			5,353,982
			26,164
			379,827
			<u>5,759,973</u>
			1,558,295
			(3,324,287)
			<u>\$ (1,765,992)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**Balance Sheet - Governmental Funds**

June 30, 2009

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
Assets				
Cash	\$ 3,919,236	\$ 259,179	\$ 1,349,436	\$ 5,527,851
Taxes receivable	141,601		77,237	218,838
Due from other funds	312,240	(312,240)		
Due from other governments	239,366	277,858		517,224
Due from others	17,149			17,149
Prepaid expenses	46,405			46,405
Total assets	<u>\$ 4,675,997</u>	<u>\$ 224,797</u>	<u>\$ 1,426,673</u>	<u>\$ 6,327,467</u>
 Liabilities and Fund Balance				
Liabilities:				
Accounts payable	\$ 213,159	\$ 72,868	\$	\$ 286,027
Retainage Payable		6,044		6,044
Deferred revenue	141,601		77,237	218,838
Total liabilities	<u>354,760</u>	<u>78,912</u>	<u>77,237</u>	<u>510,909</u>
 Fund balances:				
Reserved for:				
Prepaid expenses	46,405			46,405
Debt service			1,349,436	1,349,436
Authorized construction		145,885		145,885
Unreserved	4,274,832			4,274,832
Total fund balances	<u>4,321,237</u>	<u>145,885</u>	<u>1,349,436</u>	<u>5,816,558</u>
Total liabilities and fund balances	<u>\$ 4,675,997</u>	<u>\$ 224,797</u>	<u>\$ 1,426,673</u>	<u>\$ 6,327,467</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT # 1

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

June 30, 2009

Total fund balance, governmental funds \$ 5,816,558

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds.

Historical cost	\$ 14,943,442	
Less accumulated depreciation	<u>(10,054,746)</u>	
Difference due to capital assets		4,888,696

Property taxes receivable and related penalties and interest have been levied and are due, but are not available soon enough to pay current period expenditures and, therefore, are deferred in the funds.

Property taxes receivable	141,970	
Penalty and interest receivable	<u>76,868</u>	
Difference due to property taxes		218,838

Some liabilities are not due and payable in the current period and are not included in the fund financial statements, but are included in the government wide statements. These are as follows:

Bonds payable and related discount	(12,491,396)	
Accrued interest	(175,925)	
Compensated absences	<u>(22,763)</u>	
Difference due to long term obligations		(12,690,084)

Net Assets of Governmental Activities in the Statement of Net Assets	<u><u>\$ (1,765,992)</u></u>
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See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT #1*Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds**For the Year Ended June 30, 2009*

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
Revenues				
Property taxes	\$ 4,153,499	\$	\$ 1,181,594	\$ 5,335,093
Intergovernmental	471,846	333,874		805,720
Charges for services				
Investment earnings	18,865	1,716	5,583	26,164
Miscellaneous		379,827		379,827
Total revenues	<u>4,644,210</u>	<u>715,417</u>	<u>1,187,177</u>	<u>6,546,804</u>
Expenditures				
Current:				
Planning and engineering	74,809			74,809
Traffic control	419,012			419,012
Maintenance and beautification	1,371,418			1,371,418
General and administrative	1,313,090		991	1,314,081
Uptown shuttle				
Marketing and communications	336,858			336,858
Economic development	108,492			108,492
Debt Service:				
Principal			565,000	565,000
Interest and other charges		8,399	518,002	526,401
Capital Outlay		<u>658,923</u>		<u>658,923</u>
Total expenditures	<u>3,623,679</u>	<u>667,322</u>	<u>1,083,993</u>	<u>5,374,994</u>
Excess (deficiency) of revenues over expenditures	<u>1,020,531</u>	<u>48,095</u>	<u>103,184</u>	<u>1,171,810</u>
Net change in fund balance	1,020,531	48,095	103,184	1,171,810
Fund balances - beginning of year	3,300,705	97,790	1,246,252	4,644,748
Fund balances - end of year	<u>\$ 4,321,236</u>	<u>\$ 145,885</u>	<u>\$ 1,349,436</u>	<u>\$ 5,816,558</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT # 1

***Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2009***

Net change in fund balances - total governmental funds: \$ 1,171,810

Amounts reported for Governmental Activities in the Statement of Activities are different because:

Governmental funds do not report revenues that are not available to pay current obligations. In contrast, such revenues are reported in the Statement of Activities when earned. The difference is for property taxes and related penalties and interest. 18,890

Governmental funds report outlays for capital assets as expenditures. However, in the Statement of Activities the costs of those assets is allocated over their estimated useful lives and reported as depreciation expense for the period.

Capital outlay expenditures	\$ 476,241	
Depreciation expense	<u>(651,511)</u>	
Difference due to capital assets		(175,270)

The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of principal uses current financial resources. However, at the government wide level these transactions have the effect of increasing or decreasing long-term liabilities. 565,000

Some expenses reported in the statement of activities do not require the use of current financial resources and are not reported as expenditures in governmental funds. These are as follows:

Amortization of issuance costs		
Increase in liability for compensated absences	(7,827)	
Interest expense accrual	<u>(14,308)</u>	
		(22,135)

Change in net assets of governmental activities	<u>\$ 1,558,295</u>
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See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 1 – Summary of Significant Accounting Policies

The financial statements of Harris County Improvement District No. 1 (“the District”) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Government Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and reporting principles. The following is a summary of the most significant policies.

Creation

Harris County Improvement District No. 1 (the “District”) was organized, created, and established pursuant to an act of the 70th Texas State Legislature, effective under the terms and provisions of Article III, Section 52 and Article XVI, Section 59 of the Texas Constitution. The Board of Directors held its organizational meeting on July 18, 1987. The first bonds were sold on June 23, 1993. See Note 6 for additional information regarding significant legal provisions contained in the legislative act creating the District.

The District's primary activities include managing and financing improvement projects and/or services benefiting the District. These activities include maintenance and beautification of the area, traffic control and transportation projects, special events for the holiday seasons, general planning and engineering, area marketing, major capital improvements and general and administrative services.

Reporting Entity

The District is a political subdivision of the State of Texas, governed by an appointed board, and is considered a primary government. The GASB has established the criteria for determining whether or not an entity is a primary government or a component unit of a primary government. The primary criteria are that it has a separately elected governing body; it is legally separate; and it is fiscally independent of other state and local governments. Under these criteria, the District is considered a primary government and is not a component unit of any other government. Additionally, no other entities meet the criteria for inclusion in the District's financial statements as component units.

Government-wide and Fund Financial Statements

Government-wide financial statements display information about the District as a whole. These statements focus on the sustainability of the District as an entity and the change in aggregate financial position resulting from activities of the fiscal period. Interfund activity, if any, has been removed from these statements. The government wide statements consist of the *Statement of Net Assets* and the *Statement of Activities*.

The *Statement of Activities* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenue includes: 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 segment. Taxes and other items not properly included among program revenues are reported as general revenues.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 1 – Summary of Significant Accounting Policies (continued)

Fund financial statements display information at the individual fund level. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for a specific purpose. Each fund is considered to be a separate accounting entity. These fund financial statements are the *Governmental Funds- Balance Sheet* and the *Governmental Funds - Statement of Revenues, Expenditures and Changes in Fund Balances*

The District reports the following major governmental funds:

The *General Fund* is used to account for administrative operations of the District. The principal source of revenue is property taxes. Expenditures include all costs associated with the daily operations of the District.

The *Debt Service Fund* is used to account for the payment of interest and principal on all general long-term debt of the District. The primary source of revenue is provided by contract tax increment revenue.

The *Capital Projects Fund* is used to account for the expenditure of bond proceeds used in the construction of authorized improvement projects.

Measurement Focus and Basis of Accounting

The Government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recognized 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 are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental 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 if they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally 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.

Annual Financial Plan (Non-Appropriated Budget)

The District does not adopt annual appropriated budgets for its funds. The Board of Directors, however, does adopt annual financial plans for the General Fund. The plans are reviewed by management and the Board throughout the year in controlling and enhancing the District's operating results. The Board generally considers the District's final annual actual operating results for all funds representative of the District's annual financial plans for that year.

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. At June 30, 2009, an allowance for uncollectible property tax accounts was not considered necessary.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 1 – Summary of Significant Accounting Policies (continued)

Prepaid Expenditures

Certain payments made by the District reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

Capital Assets

Capital assets are reported in the government-wide financial statements. The District defines capital assets as assets with an initial, individual cost of \$5,000 or more and an estimated useful life in excess of one year. Capital assets are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at the estimated fair value at the date of donation. Assets are depreciated over their remaining useful lives using the straight-line method.

<u>Asset</u>	<u>Estimated Useful Lives</u>
Machinery and Equipment	10 – 20 years

Fund Equity

In the fund financial statements, reserved or designated equity balances represent those portions of fund balance not appropriable for expenditures or legally segregated for a specific future use. Undesignated fund balances represent available balances for the District's future use.

The District applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Interfund Activity

During the course of operations, transactions occur between individual funds. This can include internal transfers, payables and receivables. This activity is combined as internal balances and is eliminated in both the government-wide and fund financial statements.

Compensated Absences

The District's employees earn vacation leave, which may either be taken or accumulated, up to certain amounts, until paid upon termination or retirement. The amounts are recorded as a liability on the *Statement of Net Assets*.

Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 2 – Deposits and Investments

As of June 30, 2009, the carrying value (which approximates market value) of the District’s cash and investments were as follows:

	Carrying Value
Demand and time deposits	\$ 5,527,852
	<u>\$ 5,527,852</u>

Authorized Investments

The District is authorized by the *Public Funds Investment Act* (Chapter 2256, Texas Government Code) to invest in the following: (1) obligations of the United States or its agencies and instrumentalities, (2) direct obligations of the State of Texas or its agencies and instrumentalities, (3) certain collateralized mortgage obligations, (4) other obligations, which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies or instrumentalities, (5) certain A rated or higher obligations of states and political subdivisions of any state, (6) bonds issued, assumed or guaranteed by the State of Israel, (7) insured or collateralized certificates of deposit, (8) certain fully collateralized repurchase agreements, (9) bankers’ acceptances with limitations, (10) commercial paper rated A-1 or P-1 or higher and a maturity of 270 days or less, (11) no-load money market mutual funds and no-load mutual funds, with limitations, (12) certain guaranteed investment contracts, (13) certain qualified governmental investment pools and (14) a qualified securities lending program.

The District has adopted a written investment policy to establish the principles by which the District’s investment program should be managed. This policy further restricts the types of investments in which the District may invest.

Investment Credit and Interest Rate Risk

Investment credit risk is the risk that the investor may not recover the value of an investment from the issuer, while interest rate risk is the risk that the value of an investment will be adversely affected by changes in interest rates. The Authority’s investment policies do not address investment credit and interest rate risk beyond the rating and maturity restrictions established by state statutes.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 3 – Capital Assets

A summary of changes in capital assets, for the year ended June 30, 2009, follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Balance</u>
Capital assets being depreciated:			
Machinery and equipment	\$ 14,467,201	\$ 476,241	\$ 14,943,442
Less accumulated depreciation	(9,403,235)	(651,511)	(10,054,746)
Capital assets, net	<u>\$ 5,063,966</u>	<u>\$ (175,270)</u>	<u>\$ 4,888,696</u>

Depreciation was charged to functions of the District as follows:

Traffic control	\$ 649,011
Marketing and communications	2,500
	<u>\$ 651,511</u>

Note 4 – Long – Term Liabilities

As of June 30, 2009, the District's long-term liabilities are comprised of the following:

	<u>Balance</u>	<u>Due Within One Year</u>
Bonds payable	\$ 12,675,000	\$ 590,000
Unamortized discounts	(43,437)	
Deferred difference on refunding	(140,167)	
Compensated absences	22,763	
	<u>\$ 12,514,159</u>	<u>\$ 590,000</u>

During the year, the District's long-term liabilities changed as follows:

	<u>Beginning Balance</u>	<u>Reductions</u>	<u>Ending Balance</u>
Unlimited tax bonds	\$ 13,240,000	\$ (565,000)	\$ 12,675,000
Unamortized discounts	(46,213)	2,776	(43,437)
Deferred difference on refunding	(154,314)	14,147	(140,167)
Compensated absences	14,936	7,827	22,763
	<u>\$ 13,054,409</u>	<u>\$ (540,250)</u>	<u>\$ 12,514,159</u>

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 4 – Long – Term Liabilities (continued)

Bonds payable consist of the following:

Series	Amount Outstanding	Original Issue	Interest Rate	Maturity Date,		
				Serially, Beginning/ Ending	Interest Payment Dates	Call Dates
Unlimited Tax Bonds, Series 1999	\$ 1,575,000	\$ 2,000,000	5.00%-7.00%	Sep 1, 2001-2023	Mar 1 Sep 1	Sep 1, 2009
Unlimited Tax Improvement and Refunding Bonds, Series 2004	11,100,000	13,635,000	2.00%-5.00%			
Total	<u>\$ 12,675,000</u>					

Payment of principal and interest on the bonds is to be provided from tax levies on properties within the District. As the bonds are unlimited tax bonds, no other funds of the District have been pledged for debt service requirements. Investment income realized by the Debt Service Fund, from investment of excess funds, will be used to pay outstanding bond principal and interest. The District is in compliance with all significant requirements and restrictions contained in its bond resolution.

Annual debt service requirements to retire these outstanding bonds are as follows:

Year Ending June 30,	Principal	Interest	Total
2010	\$ 590,000	\$ 508,910	\$ 1,098,910
2011	610,000	493,433	1,103,433
2012	640,000	475,713	1,115,713
2013	675,000	455,900	1,130,900
2014	705,000	433,123	1,138,123
2015	745,000	408,600	1,153,600
2016	785,000	381,216	1,166,216
2017	830,000	351,557	1,181,557
2018	875,000	318,615	1,193,615
2019	920,000	282,806	1,202,806
2020	965,000	243,968	1,208,968
2021	1,015,000	203,008	1,218,008
2022	1,060,000	158,816	1,218,816
2023	1,105,000	111,348	1,216,348
2024	1,155,000	54,553	1,209,553
	<u>\$ 12,675,000</u>	<u>\$ 4,881,563</u>	<u>\$ 17,556,563</u>

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 4 – Long – Term Liabilities (continued)

A summary of District Bonds authorized, but unissued at June 30, 2009 follows:

<u>Purpose</u>	<u>Date</u>	<u>Amount</u>	<u>Amount</u>
	<u>Authorized</u>	<u>Authorized</u>	<u>Unissued</u>
Stimulation and development of transportation	05/30/92	\$ 75,000,000	\$ 59,915,000
Conservation and preservation of natural resources	05/30/92	25,000,000	22,005,000
Improvement projects payable from assessments	05/30/92	25,000,000	25,000,000
Improvement projects for economic diversification	11/20/93	25,000,000	25,000,000
		<u>\$150,000,000</u>	<u>\$ 131,920,000</u>

Note 5 – Property Taxes

On May 30, 1992, the voters of the District authorized the District's Board of Directors to levy taxes annually for use in financing general operations (maintenance tax) limited to \$0.25 per \$100 of assessed property valuation. The Harris County Appraisal District determines all property valuations and exempt status, if any. The District's bond resolution requires that property taxes be levied for use in paying interest and principal on long-term debt and for use in paying costs incurred in assessment and collection of these taxes. Taxes levied for debt service and related costs are without limitation as to rate or amount.

The District has contracted with the Harris County Tax Assessor/Collector for its tax levy and collection functions. A tax lien attaches to properties within the District on January 1st of each year when property valuations for use in levying taxes are established. Taxes levied are generally billed in October and are due upon receipt of the tax bill. Penalty and interest are charged if taxes are not paid by January 31st. There is an additional 15% penalty charged on accounts delinquent after July 1st, which generally is payable to the District's delinquent tax attorney.

Property taxes are collected based on rates adopted in the year of the levy. The District's fiscal year ended June 30, 2009 was financed through the 2008 tax levy. The District levied property taxes of \$0.1435 per \$100 of assessed value, of which \$0.1117 was allocated to maintenance and operations and \$0.0318 was allocated to debt service. The resulting tax levy was \$5,324,637 on the adjusted taxable value of \$3,710,549,222.

Taxes receivable, at June 30, 2009, consist of the following:

Current year taxes receivable	\$ 40,474
Delinquent taxes receivable	101,496
	<u>141,970</u>

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 6 – Significant Legal Provisions of Legislative Act Creating District

As discussed in Note 1 above, the District has been established pursuant to an act of the Texas State Legislature. Significant legal provisions of this act are summarized below.

District Boundaries

The Act provides specifically for boundaries of the District, which includes the Uptown Houston area. The Uptown Houston area is also known as the Galleria-Post Oak area in Houston, Texas. The District may annex additional land area in accordance with Chapter 54 of the Texas Water Code.

Texas Commission on Environmental Quality Involvement

The Act provides that the Texas Commission on Environmental Quality is to appoint District Directors. The Directors are to serve staggered four-year terms. Additionally, the Texas Commission on Environmental Quality must approve the issuance of any bonded indebtedness for the purposes of providing water, sewer or drainage facilities within the District. No other District activities are subject to the jurisdiction of the Texas Commission on Environmental Quality.

General and Specific Powers of the District

The Act provides general powers to the District subject to general laws and regulations of the state applicable to conservation and reclamation districts created under Article XVI, Section 59 of the Texas Constitution and road districts and road utility districts created pursuant to Article III, Section 52, of the Texas Constitution, including those conferred by Chapter 54 of the Water Code and Chapter 13, Acts of the 68th legislature, 2nd Called Session, 1984 (Article 6674r-1, Vernon's Texas Civil Statutes).

Additional specific powers and duties are provided for in the act, which include the financing of improvement projects and/or services for the benefit of the District. Specific types of improvement projects are provided for in the act and include the acquisition of land in connection with the improvements. Eminent domain powers are specifically prohibited by the act. Improvement projects and/or services may be financed in whole or in part by the levy and collection of special assessments or property taxes on property in the area. The act also provides that maintenance taxes may be levied after voter approval.

The Act provides for the method by which the District must petition, provide notice and hold public hearings prior to the financing of the improvement projects and/or services.

The Act also provides for the issuance of voter approved bonded indebtedness to finance improvement projects and/or services. Specific guidelines in the act provide for the repayment of bonds, which might be issued, as well as the use of bond proceeds, available security that can be pledged in issuing the bonds and refunding capabilities for outstanding bonds.

Director Bonds

The Act requires that each Director appointed execute a bond for \$10,000 payable to the District and conditioned on faithful performance of his or her duties. All bonds of the Directors shall be approved by the Board.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 6 – Significant Legal Provisions of Legislative Act Creating District (continued)

Other Provisions

Other significant provisions of the act include City of Houston approval requirements for issuance of bonds for all improvement projects, bonded indebtedness limits, contracting powers, dissolution procedures, director qualifications and procedural requirements regarding Board meetings and District business matters.

Note 7 – Operating Agreement – Uptown Houston Association

The District has entered into an operating agreement with Uptown Houston Association (the “Association”). The Association is a non-profit corporation formed to carry on maintenance and improvements in the Uptown Houston area. The governing boards of both the District and the Association have common members. It is the intent of both governing boards to maintain separately controlled operating entities. The agreement calls for the District to perform many of the functions previously performed by the Association, primarily the maintenance, enhancement and marketing of the Uptown Houston area. Additionally, the Association has granted the District the use of Association assets without charge to the District. Financial information regarding the Association can be obtained from Uptown Houston Association, 1980 Post Oak Boulevard #1580, Houston, Texas 77056.

Note 8 – Pension Plan

For the benefit of its employees, the District provides discretionary contributions to a simplified employee pension plan, meeting the requirements of Internal Revenue Code Section 408(k). For the year ended June 30, 2009, the District contributed \$71,292 to the plan.

Note 9 – Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and personal injuries. The risk of loss is covered by commercial insurance. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for current year or the three prior years.

Note 10 – Tax Increment Reinvestment Zone

During the current and prior years, the District incurred certain planning expenditures related to the Tax Increment Reinvestment Zone No. 16 of the City of Houston (TIRZ). The TIRZ is located on property generally within the District’s service area. During the year ended June 30, 2009, the District received \$455,215 from the TIRZ for reimbursement of administration costs, project management costs and traffic and mobility costs.

Note 11 – Texas Department of Transportation Grant

The District is a recipient of a Federal Highway Administration grant for Highway Planning and Construction passed through to the District by the Texas Department of Transportation. The District has passed the proceeds of this grant, *Intelligent Transportation Systems Program - Condition Responsive Uptown Traveler Information System*, through to the Uptown Development Authority (UDA) and TIRZ. The TIRZ expends all funds for purposes of the grant, including a 20% local matching requirement under the grant terms. All grant revenues are recognized by the District based on TIRZ spending and are then passed through to the TIRZ as a reimbursement for grant related spending.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2009

Note 11 – Texas Department of Transportation Grant (continued)

There was no additional spending under the grant for the year ended June 30, 2009. A summary of grant activity, from inception in fiscal 2004 through June 30, 2009, is shown below along with similar information for the total grant.

<u>Funding Source</u>	<u>Amounts</u>	
	<u>Actual through June 30, 2009</u>	<u>Total Grant</u>
Federal Highway Administration (80%)	\$ 1,019,789	\$1,015,112
District/UDA/TIRZ (20%)	254,947	253,778
	<u>\$ 1,274,736</u>	<u>\$ 1,268,890</u>

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Required Supplementary Information

HARRIS COUNTY IMPROVEMENT DISTRICT #1**General Fund****Schedule of Revenues, Expenditures and Changed in Fund Balances - Budget to Actual****June 30, 2009**

	Original and Final Budget	Actual	Variance with Final Budget Positive / (Negative)
Revenues			
Property taxes	\$ 3,815,220	\$ 4,153,499	\$ 338,279
Intergovernmental	455,207	455,246	39
Shelter program	33,300	16,600	(16,700)
Investment earnings	75,000	18,865	(56,135)
HGAC Grants	2,078,400		(2,078,400)
Total revenues	6,457,127	4,644,210	(1,812,917)
Expenditures			
Current:			
Planning and engineering	687,000	74,809	612,191
Traffic control	464,000	419,012	44,988
Maintenance and beautification	1,310,700	1,371,418	(60,718)
General and administrative	1,350,643	1,313,090	37,553
Marketing and communications	310,000	336,858	(26,858)
Economic development	73,000	108,492	(35,492)
Total expenditures	4,195,343	3,623,679	571,664
Excess (deficiency) of revenues over expenditures	2,261,784	1,020,531	(1,241,253)
OTHER FINANCING SOURCES (USES)			
Transfers out	(2,261,784)		2,261,784
Total other financing sources (uses)	(2,261,784)		2,261,784
Net change in fund balance		1,020,531	1,020,531
Fund balances - beginning of year	3,300,705	3,300,705	
Fund balances - end of year	\$ 3,300,705	\$ 4,321,236	\$ 1,020,531

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to Required Supplementary Information

June 30, 2009

Budgets and Budgetary Accounting

A non-appropriated budget is adopted for the General Fund by the District’s Board of Directors. The budget is prepared using the same method of accounting as for the financial reporting. The budget is considered a planning tool and does constitute legal spending limit authority. There were no amendments to the budget during the year.

For the year ended June 30, 2009, actual expenditures exceeded budgeted amounts as follows:

Maintenance and beautification	\$ 60,718
Marketing and Communications	26,858
Economic Development	35,492