

**HARRIS COUNTY
IMPROVEMENT DISTRICT NO. 1**

HOUSTON, TEXAS

FINANCIAL REPORT

June 30, 2007

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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"), as of and for the year ended June 30, 2007, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 District's governmental activities and each major fund as of June 30, 2007, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2008 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Board of Directors
Harris County Improvement District No. 1
Houston, Texas
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The management's discussion and analysis and budgetary comparison information on pages 5 through 10 and 30 through 31 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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.

A handwritten signature in black ink that reads "Nell Garrison, P.E." The signature is written in a cursive, flowing style.

Houston, Texas
April 15, 2008

Management's Discussion and Analysis

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HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2007

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, 2007.

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, 2007

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, 2007, were a negative \$2,825,312. The principal reason for this deficit is the District incurred long-term debt in 1999 to construct approximately \$2 million in infrastructure, which it 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 \$12,227,126. Of this amount, \$6,847,867 consists of cash and investments and \$4,245,660 of capital assets. Total liabilities were \$15,052,438 as of year-end. Of this amount, \$13,203,562 consisted of long-term debt and accrued interest. The 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, 2007 and 2006, is as follows:

	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 7,981,466	\$ 7,262,616
Capital assets	4,245,660	4,796,128
Total Assets	<u>12,227,126</u>	<u>12,058,744</u>
Other liabilities	2,029,888	1,203,765
Long-term liabilities	13,022,550	13,785,000
Total Liabilities	<u>15,052,438</u>	<u>14,988,765</u>
Net assets:		
Invested in capital assets, net of related debt	(6,411,135)	(5,666,640)
Restricted	1,061,722	859,755
Unrestricted	2,524,101	1,876,864
Total Net Assets	<u>\$ (2,825,312)</u>	<u>\$ (2,930,021)</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2007

Government-wide Financial Analysis (continued)

The total net assets of the District increased by, \$104,709. A comparative summary of the District's statement of activities for the past two years is as follows:

	<u>2007</u>	<u>2006</u>
Revenues		
Program revenue		
Charges for services	\$ 2,700,704	\$ 2,678,385
General revenues		
Property taxes	4,021,890	3,538,872
Unrestricted investment earnings	282,120	339,366
Miscellaneous	65,425	
Total Revenues	<u>7,070,139</u>	<u>6,556,623</u>
Expenses		
General and administrative	1,295,432	1,271,479
Traffic control	959,819	927,210
Maintenance and beautification	909,359	898,998
Planning and engineering	203,514	95,935
Marketing and communications	255,862	249,815
Interest on Long-term debt	416,431	569,123
Economic development	61,704	72,239
Metro		1,505,278
Construction on behalf of the City of Houston	1,719,540	1,293,001
Transfers to other governments	1,143,769	
Total Expenses	<u>6,965,430</u>	<u>6,883,078</u>
Decrease in net assets	104,709	(326,455)
Net assets-beginning	<u>(2,930,021)</u>	<u>(2,603,566)</u>
Net Assets - Ending	<u>\$ (2,825,312)</u>	<u>\$ (2,930,021)</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 \$6,490,167, a decrease of \$100,840 in comparison with the prior year. This is due to capital spending and related grant pass throughs to the Uptown Development Authority. The unreserved portion of fund balance is \$2,359,226. 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 (\$2,910,755) and 2) to pay debt service (\$1,189,429).

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2007

Financial Analysis of the Government's Funds (continued)

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

	<u>2007</u>	<u>Increase (Decrease)</u>	<u>2006</u>	<u>Increase (Decrease)</u>	<u>2005</u>
General Fund	\$ 2,389,983	\$ 524,106	\$ 1,865,877	\$ 122,139	\$ 1,743,738
Capital Projects Fund	2,910,755	(702,069)	3,612,824	(412,728)	4,025,552
Debt Service Fund	1,189,429	77,123	1,112,306	71,593	1,040,713
	<u>\$ 6,490,167</u>	<u>\$ (100,840)</u>	<u>\$ 6,591,007</u>	<u>\$ (218,996)</u>	<u>\$ 6,810,003</u>

The General Fund is the chief operating fund of the District. Fund balance in the General Fund increased by \$524,106 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 \$2,359,226, while expenditures for the year were \$2,924,743.

The Debt Service Fund has a total fund balance of \$1,189,429, 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 \$77,123.

The Capital Projects Fund has a total fund balance of \$2,910,755, all of which is reserved for authorized construction. The net decrease in fund balance during the current year in the Capital Projects Fund of \$702,069 is related to capital expenditures for the West Loop Greening Project and pass throughs to Uptown Development Authority related to the priority corridor project. Both of these projects were funded by the Texas Department of Transportation.

General Fund Budgetary Highlights

The Board of Directors did not amend the budget during the year. The District anticipated an increase in the fund balance of \$4,151, while the actual increase was \$524,106. Variances between budget and actual were due primarily to positive budget variances in property tax revenues and operational spending.

Debt Administration

At June 30, 2007 and 2006, the District had total bonded debt outstanding as shown below:

<u>Series</u>	<u>2007</u>	<u>2006</u>
Series 1999	\$ 1,700,000	\$ 1,755,000
Series 2004	12,085,000	12,565,000
	<u>\$ 13,785,000</u>	<u>\$ 14,320,000</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2007

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 2006 was \$0.1435 per \$100 of assessed value. The tax rate will remain the same for tax year 2007, with expected revenues of approximately \$4,128,353 million.

Office Space

Uptown has over 23 million square feet of office space. In the commercial sector, the vacancy rate has declined from 26% to 9% in the past three years, less than the city average. This achievement, coupled with a wealth of recent lease renewals as well as new leases, 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 have increased by 19% in fiscal year 2007, primarily because of the overall strength of the Uptown office market. 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 three years, the current market conditions are impressive.

The Uptown Class A office market ended the second quarter 2007 with a vacancy rate of 10%, which is significant considering the vacancy rate three years prior for mid-year 2004 was at its highest at 26%. The Uptown Class A office market has absorbed over 128,000 square feet in 2007. Uptown's average quoted office rate for Class A space is now \$25.63, again compared to \$19.56 in mid-year 2004.

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 7% in 2007. This market continues to perform, as The Galleria is now the fourth largest retail center in the United States. In late 2007, a 22-acre mixed-use development known as BLVD. Place will break ground. This project will feature over 400,000 square feet of upscale retail stores and restaurants.

According to CoStar's mid-year Retail Market Report, Uptown Houston's retail market has the lowest vacancy rate of any submarket in the region at 2.9%. Also, quoted lease rates were among the highest in the region at \$23.50 per square foot.

Hotel

Uptown welcomed two new hotels in the past year, and two more are currently under construction. In total, 31 first quality hotels call Uptown home, offering more than 7,000 rooms for guests.

The area's RevPAR (revenues per available room) are among the city's highest at \$103.20 (compared to \$100 from the same time last year). Uptown Houston also boasts one of the highest occupancy rates in the city at 73%.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

Management's Discussion and Analysis

June 30, 2007

Residential

Seven new high-rise residential towers have been built in Uptown in the past six years and occupancy rates are among the highest in the city at 93.6%. With more than 30,000 residences, Uptown Houston is one of the most prestigious and desirable areas to live.

Projects currently under construction include The Cosmopolitan and The Alexan. The Cosmopolitan, a 20-story, deluxe high-rise condominium, is located at 1600 Post Oak Boulevard. The 75-unit project will range in price from \$300,000 to \$1 million. The Alexan Post Oak, a luxury apartment complex currently under construction at 1111 Post Oak Boulevard, will add another 392 Class A units to the market. Additionally, several other new Class A apartment and condominium projects are planned for the Uptown area, including the Turnberry Tower, a 34-story luxury tower with units priced up to \$8.5 million.

Uptown Class A Apartment Market Fast Facts:

Average Square Footage per Unit: 1,006 square feet

Average Occupancy Rate 94%

Average Market Rent per Unit: \$1,351

The economic factors affecting Uptown, while encouraging, are difficult to forecast. However, with the new construction and promising proposed developments on the horizon, the Uptown district remains a viable district.

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.

Basic Financial Statements

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HARRIS COUNTY IMPROVEMENT DISTRICT # 1
Statement of Net Assets - Governmental Activities
June 30, 2007

Assets	
Cash	\$ 6,847,867
Property taxes receivable	215,277
Due from other governments	887,017
Other receivables	548
Prepaid expenses	30,757
Capital assets, net of depreciation	4,245,660
Total Assets	<u>12,227,126</u>
 Liabilities	
Accounts payable and accrued expenses	329,308
Retainage payable	132,945
Due to Uptown Development Authority	813,769
Accrued interest	181,012
Long term debt	
Due in less than one year	572,854
Due in more than one year	13,022,550
Total liabilities	<u>15,052,438</u>
 Net Assets	
Invested in capital assets, net of related debt	(6,411,135)
Restricted for debt service	1,061,722
Unrestricted	2,524,101
Total net assets	<u>\$ (2,825,312)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT # 1
Statement of Activities - Governmental Activities
For the Year Ended June 30, 2007

<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	\$ 1,295,432	\$ 488,478	\$ (806,954)
Traffic control	959,819		(959,819)
Maintenance and beautification	909,359		(909,359)
Planning and engineering	203,514		(203,514)
Marketing and communications	255,862		(255,862)
Interest on long-term debt	416,431		(416,431)
Economic development	61,704		(61,704)
Construction on behalf of the City of Houston	1,719,540	2,212,226	492,686
Total activities	<u>5,821,661</u>	<u>2,700,704</u>	<u>(3,120,957)</u>
General revenues:			
			4,021,890
			282,120
			65,425
			<u>(1,143,769)</u>
			<u>3,225,666</u>
			104,709
			<u>(2,930,021)</u>
			<u>\$ (2,825,312)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1
Balance Sheet - Governmental Funds
June 30, 2007

	General Fund	Capital Projects	Debt Service	Total Governmental Funds
Assets				
Cash	\$ 2,341,508	\$ 3,316,930	\$ 1,189,429	\$ 6,847,867
Taxes receivable	142,622		72,655	215,277
Due from other governments	53,913	833,104		887,017
Due from others	548			548
Prepaid expenses	30,757			30,757
Total assets	<u>\$ 2,569,348</u>	<u>\$ 4,150,034</u>	<u>\$ 1,262,084</u>	<u>\$ 7,981,466</u>
 Liabilities and Fund Balance				
Liabilities:				
Accounts payable	\$ 36,743	\$ 292,565	\$	\$ 329,308
Retainage Payable		132,945		132,945
Deferred revenue	142,622		72,655	215,277
Due to Uptown Development Authority		813,769		813,769
Total liabilities	<u>179,365</u>	<u>1,239,279</u>	<u>72,655</u>	<u>1,491,299</u>
 Fund balances:				
Reserved for:				
Prepaid expenses	30,757			30,757
Debt service			1,189,429	1,189,429
Authorized construction		2,910,755		2,910,755
Unreserved	2,359,226			2,359,226
Total fund balances	<u>2,389,983</u>	<u>2,910,755</u>	<u>1,189,429</u>	<u>6,490,167</u>
Total liabilities and fund balances	<u>\$ 2,569,348</u>	<u>\$ 4,150,034</u>	<u>\$ 1,262,084</u>	<u>\$ 7,981,466</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, 2007

Total fund balance, governmental funds \$ 6,490,167

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	\$ 13,078,037	
Less accumulated depreciation	<u>(8,832,377)</u>	
Difference due to capital assets		4,245,660

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	157,945	
Penalty and interest receivable	<u>57,332</u>	
Difference due to property taxes		215,277

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	(13,567,550)	
Accrued interest	(181,012)	
Compensated absences	<u>(27,854)</u>	
Difference due to long term obligations		(13,776,416)

Net Assets of Governmental Activities in the Statement of Net Assets \$ (2,825,312)

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, 2007*

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
Revenues				
Property taxes	\$ 2,809,964	\$	\$ 1,129,815	\$ 3,939,779
Intergovernmental	488,478	2,212,226		2,700,704
Investment earnings	85,382	157,304	39,434	282,120
Miscellaneous	65,025	400		65,425
Total revenues	<u>3,448,849</u>	<u>2,369,930</u>	<u>1,169,249</u>	<u>6,988,028</u>
Expenditures				
Current:				
Planning and engineering	88,289	115,225		203,514
Traffic control	361,461			361,461
Maintenance and beautification	863,824			863,824
General and administrative	1,293,603		11,505	1,305,108
Marketing and communications	255,862			255,862
Economic development	61,704			61,704
Debt Service:				
Principal			535,000	535,000
Interest and other charges		40	545,621	545,661
Capital Outlay		<u>1,812,965</u>		<u>1,812,965</u>
Total expenditures	<u>2,924,743</u>	<u>1,928,230</u>	<u>1,092,126</u>	<u>5,945,099</u>
Excess (deficiency) of revenues over expenditures	<u>524,106</u>	<u>441,700</u>	<u>77,123</u>	<u>1,042,929</u>
Other Financing Sources:				
Transfers to Uptown Development Authority		<u>(1,143,769)</u>		<u>(1,143,769)</u>
Total other financing uses		<u>(1,143,769)</u>		<u>(1,143,769)</u>
Net change in fund balance	524,106	(702,069)	77,123	(100,840)
Fund balances - beginning of year	<u>1,865,877</u>	<u>3,612,824</u>	<u>1,112,306</u>	<u>6,591,007</u>
Fund balances - end of year	<u>\$ 2,389,983</u>	<u>\$ 2,910,755</u>	<u>\$ 1,189,429</u>	<u>\$ 6,490,167</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, 2007***

Net change in fund balances - total governmental funds: \$ (100,840)

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. 82,111

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	\$ 93,425	
Depreciation expense	(643,893)	
Difference due to capital assets		(550,468)

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. 535,000

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:

Increase in liability for compensated absences	9,676	
Interest expense accrual	129,230	
		138,906

Change in net assets of governmental activities		<u>\$ 104,709</u>
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See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

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, 2007

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.

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, 2007, an allowance for uncollectible property tax accounts was not considered necessary.

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.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

Note 1 – Summary of Significant Accounting Policies (continued)

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, 2007

Note 2 – Deposits and Investments

Deposit Custodial Credit Risk

Custodial credit risk as it applies to deposits is the risk that, in the event of the failure of the depository institution, a government will not be able to recover its deposits or will not be able to recover collateral securities. The *Public Funds Collateral Act* (Chapter 2257, Texas Government Code) requires that all of the District's deposits with financial institutions be covered by federal depository insurance and, if necessary, pledged collateral held by a third party custodian. The act further specifies the types of securities that can be used as collateral. The District's written investment policy establishes additional requirements for collateralization of deposits.

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.

Note 3 – Capital Assets

A summary of changes in capital assets, for the year ended June 30, 2007, follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Balance</u>
Capital assets being depreciated:			
Machinery and equipment	\$ 12,984,612	\$ 93,425	\$ 13,078,037
Less accumulated depreciation	(8,188,484)	(643,893)	(8,832,377)
Capital assets, net	<u>\$ 4,796,128</u>	<u>\$ (550,468)</u>	<u>\$ 4,245,660</u>

Depreciation was charged to functions of the District as follows:

Traffic control	\$ 598,358
Marketing and communications	45,535
	<u>\$ 643,893</u>

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

Note 4 – Long – Term Liabilities

As of June 30, 2007, the District’s long-term liabilities are comprised of the following:

	<u>Balance</u>	<u>Due Within One Year</u>
Bonds payable	\$ 13,785,000	\$ 545,000
Unamortized discounts	(48,989)	
Deferred difference on refunding	(168,461)	
Compensated absences	27,854	27,854
	<u>\$ 13,595,404</u>	<u>\$ 572,854</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	\$ 14,320,000	\$ (535,000)	\$ 13,785,000
Compensated absences	37,529	(9,675)	27,854
	<u>\$ 14,357,529</u>	<u>\$ (544,675)</u>	<u>\$ 13,812,854</u>

Bonds payable consist of the following:

<u>Series</u>	<u>Amount Outstanding</u>	<u>Original Issue</u>	<u>Interest Rate</u>	<u>Maturity Date, Serially, Beginning/ Ending</u>	<u>Interest Payment Dates</u>
Unlimited Tax Bonds, Series 1999	\$ 1,700,000	\$ 2,000,000	5.00%-7.00%	Sep 1, 2001- 2023	Mar 1 Sep 1
Unlimited Tax Improvement and Refunding Bonds, Series 2004	12,085,000	13,635,000	2.00%-5.00%		
Total activities	<u>\$ 13,785,000</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.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

Note 4 – Long – Term Liabilities (continued)

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

Year Ending June 30,	Principal	Interest	Total
2008	\$ 545,000	\$ 536,448	\$ 1,081,448
2009	565,000	522,779	1,087,779
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>\$ 13,785,000</u>	<u>\$ 5,940,790</u>	<u>\$ 19,725,790</u>

A summary of District Bonds authorized, but unissued at June 30, 2007 follows:

Purpose	Date Authorized	Amount Authorized	Amount Unissued
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
		<u>\$ 125,000,000</u>	<u>\$ 106,920,000</u>

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

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, 2007 was financed through the 2006 tax levy. The District levied property taxes of \$0.1435 per \$100 of assessed value, of which \$0.1021 was allocated to maintenance and operations and \$0.0414 was allocated to debt service. The resulting tax levy was \$3,975,485 on the adjusted taxable value of \$2,770,372,472.

Taxes receivable, at June 30, 2007, consist of the following:

Current year taxes receivable	\$ 53,883
Delinquent taxes receivable	104,062
	<hr/>
	157,945
Penalty and interest receivable	57,332
	<hr/>
Net property taxes receivable	<u>\$ 215,277</u>

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.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

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

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.

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.

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to the Financial Statements

June 30, 2007

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, 2007, the District contributed \$65,517 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, 2007, the District received \$255,215 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. Total spending under the grant, for the year ended June 30, 2007, was \$825,128. A summary of grant activity, from inception in fiscal 2004 through June 30, 2007, is shown below along with similar information for the total grant.

<u>Funding Source</u>	<u>Amounts</u>	
	<u>Actual through June 30, 2007</u>	<u>Total Grant</u>
Federal Highway Administration (80%)	\$ 953,854	\$ 1,015,112
District/UDA/TIRZ (20%)	238,464	253,778
	<u>\$ 1,192,318</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, 2007**

	Original and Final Budget	Actual	Variance with Final Budget Positive / (Negative)
Revenues			
Property taxes	\$ 2,552,265	\$ 2,809,964	\$ 257,699
Intergovernmental	455,200	488,478	33,278
Shelter program	33,300		(33,300)
Investment earnings	55,000	85,382	30,382
Miscellaneous		65,025	65,025
Total revenues	3,095,765	3,448,849	353,084
Expenditures			
Current:			
Planning and engineering	100,000	88,289	11,711
Traffic control	399,150	361,461	37,689
Maintenance and beautification	966,558	863,824	102,734
General and administrative	1,267,356	1,293,603	(26,247)
Marketing and communications	267,000	255,862	11,138
Economic development	91,550	61,704	29,846
Total expenditures	3,091,614	2,924,743	166,871
Excess (deficiency) of revenues over expenditures	4,151	524,106	519,955
Net change in fund balance	4,151	524,106	519,955
Fund balances - beginning of year	1,865,877	1,865,877	
Fund balances - end of year	\$ 1,870,028	\$ 2,389,983	\$ 519,955

HARRIS COUNTY IMPROVEMENT DISTRICT No. 1

Notes to Required Supplementary Information

June 30, 2007

Budgets and Budgetary Accounting

An annual 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. There were no significant amendments to the budget.