

**HARRIS COUNTY
IMPROVEMENT DISTRICT NO. 1**

FINANCIAL REPORT

**Year Ended June 30, 2013
with Independent Auditor's Report**

**HARRIS COUNTY
IMPROVEMENT DISTRICT NO. 1**

FINANCIAL REPORT

Year Ended June 30, 2013

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

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, 2013, and the related notes to the financial statements which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 District as of June 30, 2013, 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.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the District adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* as of June 30, 2013. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 10 and the Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget to Actual on pages 32 through 34 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Houston, Texas
December 11, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

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HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2013

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, 2013.

Overview of the Financial Statements

This discussion and analysis is 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 Position* presents information on all of the District's assets and liabilities, deferred outflows and inflows of resources with the difference reported as net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position 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 (continued)

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 deferred outflows and liabilities is called net position. As previously noted, net position may serve over time as a useful indicator of a government's financial position. The District's net position at June 30, 2013, was a negative \$1,796,444. The principal reason for this deficit is the District incurred long-term debt in 1999 and 2004 to construct infrastructure, which was conveyed to the City of Houston.

Net position is categorized based on the availability to provide financial resources for the District. Net position that is "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 position represents amounts that are restricted for future debt service requirements. "Unrestricted" net position represents amounts available to meet the District's future obligations.

At year-end, the District had total assets of \$9,456,197 and deferred outflows of \$269,096. Of this amount, \$5,700,211 consisted of cash and cash equivalents and \$2,335,039 of capital assets. The change in capital assets consisted of depreciation of \$698,526 and additions for illuminated signs for \$41,520 and two patrol vehicles for \$73,536 for the 2013 fiscal year. Total liabilities were \$11,521,737 as of year-end. Of this amount, \$10,019,169 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, 2013 and 2012, is as follows:

	<u>2013</u>	<u>2012</u>
Current and other assets	\$ 7,121,158	\$ 8,961,527
Capital assets	2,335,039	2,917,113
Total Assets	<u>9,456,197</u>	<u>11,878,640</u>
Deferred Charge on Refunding	269,096	-
Total Deferred outflows	<u>269,096</u>	<u>-</u>
Other liabilities	1,616,928	3,660,269
Long-term liabilities	9,904,809	10,068,511
Total Liabilities	<u>11,521,737</u>	<u>13,728,780</u>
Net position:		
Net investment in capital assets	2,335,039	2,917,113
Restricted	1,133,738	821,300
Unrestricted	(5,265,221)	(5,588,553)
Total Net Position	<u>\$ (1,796,444)</u>	<u>\$ (1,850,140)</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Government-wide Financial Analysis - continued

The total net position of the District increased by \$53,696. A comparative summary of the District's statement of activities for the past two years is as follows:

	<u>2013</u>	<u>2012</u>
Revenues		
Program revenue		
Charges for services	\$ 929,354	\$ 513,343
Capital Grants	3,489,103	6,868,858
General revenues		
Property taxes	5,251,213	4,617,663
Unrestricted investment earnings	12,949	43,309
Total Revenues	<u>9,682,619</u>	<u>12,043,173</u>
Expenses		
General and administrative	1,439,336	1,348,428
Traffic control	1,695,642	1,458,037
Maintenance and beautification	1,572,812	1,677,551
Planning and engineering	476,204	722,481
Marketing and communications	329,584	304,127
Interest on long-term debt	584,071	496,887
Economic development	138,813	44,403
Construction on behalf of the City of Houston	-	32,161
Transfers to other governments	3,392,461	6,326,730
Total Expenses	<u>9,628,923</u>	<u>12,410,805</u>
Increase (decrease) in net position	53,696	(367,632)
Net position - beginning	<u>(1,850,140)</u>	<u>(1,482,508)</u>
Net position - ending	<u>\$ (1,796,444)</u>	<u>\$ (1,850,140)</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, unassigned 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 \$6,144,402, an increase of \$154,088 in comparison with the prior year. This is due to increase in property tax revenues. The unassigned portion of fund balance is \$4,869,340. This amount is available for spending at the government's discretion. The remainder of fund balance is restricted to indicate that it is not available for new spending because it has already been committed to pay debt service of \$1,199,108 and nonspendable fund balance of \$75,954 related to prepaid items.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Financial Analysis of the Government's Funds - continued

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

	2013	Increase (Decrease)	2012	Increase (Decrease)	2011
General Fund	\$ 5,199,945	\$ 131,420	\$ 5,068,525	\$ (250,893)	\$ 5,319,418
Capital Projects Fund	(254,651)	(39,517)	(215,134)	(73,701)	(141,433)
Debt Service Fund	1,199,108	62,185	1,136,923	22,368	1,114,555
	<u>\$ 6,144,402</u>	<u>\$ 154,088</u>	<u>\$ 5,990,314</u>	<u>\$ (302,226)</u>	<u>\$ 6,292,540</u>

The General Fund is the chief operating fund of the District. Fund balance in the General Fund increased by \$131,420 during the current fiscal year. This increase is due to increases in property tax revenues. As a measure of the General Fund's liquidity, it may be useful to compare unassigned fund balance to total fund expenditures. At the end of the current fiscal year, the unassigned portion of fund balance of the General Fund was \$5,123,991, while expenditures for the year were \$4,938,572.

The Debt Service Fund has a total fund balance of \$1,199,108, all of which is restricted for the payment of debt service. The increase in fund balance during the current year in the Debt Service Fund was \$62,185. This was due to tax revenue receipts greater than budgeted.

The Capital Projects Fund has a total fund balance of (\$254,651), this deficit is included in the unrestricted fund balance deficit. The increase in the deficit in fund balance during the current year in the Capital Projects Fund of (\$39,517) is related to the transfer of grant funds to the Uptown Development Authority for transit related projects.

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 \$0, while the actual was an increase of \$131,420. Variances between budget and actual were due primarily to budget variances in property tax revenues and operational spending.

Debt Administration

At June 30, 2013 and 2012, the District had total bonded debt outstanding as shown below:

Series	2013	2012
Series 1999	\$ -	\$ 1,360,000
Series 2004	620,000	9,475,000
Series 2013	9,300,000	-
	<u>\$ 9,920,000</u>	<u>\$10,835,000</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

MANAGEMENT'S DISCUSSION AND ANALYSIS (*continued*)

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 2011 was \$0.1435 per \$100 of assessed value. The tax rate will remain the same for tax year 2012, with expected revenues of approximately \$5.15 million.

Office Space

Uptown Houston is one of the largest business districts outside a historic core in the United States. It is the 14th largest business district in the United States: comparable to Denver and Cleveland. With almost 24 million square feet of total office space, Uptown accounts for 16% of Houston's total 'Class A' office space with almost 17 million square feet. This is second to only Downtown Houston. There are over 200,000 office employees in the Uptown area. At the end of the fiscal year, class A office was 90% leased.

Overall, 2013 certified ad valorem values for the office sector posted a healthy 34% increase compared to an 18% increase in the previous year. In June 2013, the BBVA Compass Plaza Tower opened. The newest office tower boasts 22 stories, 312,000 square feet and LEED Gold Certification. There are currently two Class A office buildings under construction in Uptown. The Redstone Group's office development on Post Oak Boulevard is a 22-story building with approximately 308,000 square feet. Skanska USA is constructing a 20-story office tower at 3009 Post Oak Boulevard with 302,000 square feet. This office tower is scheduled to open in October 2013. As of June 2013, they are almost 80% leased. In the first quarter of 2013, BHP Billiton Petroleum unveiled its plans to build a new world headquarters building. Located at Four Oaks Place, BHP Billiton expects to break ground on the 30-story office building in late 2013.

Retail

Uptown is synonymous with shopping and is known as a world-renowned center for retail. Ad valorem values for the retail sector increased 6% in 2013. Retail was 99% leased as of the fiscal year-end. This market maintained 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. 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. Construction of Frost Bank and The Whole Foods Market is underway. Both projects are expected to open in the first quarter of 2014. The Galleria will be undergoing reconstruction at the corner of Westheimer and Sage. Once completed, an additional 100,000 square feet will be added to the mall.

Hotels

Uptown currently has 31 first quality hotels in the area, offering more than 7,100 rooms for guests. Ad valorem values for this sector increased 8% in 2013.

The area's RevPAR (revenues per available room) is the \$113.96 and comparable to the Houston Central Business District at \$114.68. The RevPAR for Houston City-wide is \$68.38. Uptown Houston also boasts one of the highest occupancy rates in the city at 77%, while the Houston City-wide occupancy rate was 68% at the end of the second quarter, 2013.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

MANAGEMENT'S DISCUSSION AND ANALYSIS (*continued*)

Residential

Seven new high-rise residential towers have been built in Uptown in the past eight years. Single-family properties are holding values with some properties increasing slightly. Multi-family properties have increased approximately 22% this year (the result of two new projects substantially complete at the beginning of the tax roll). There has been a resurgence of residential activity in the area. In addition to the six residential projects underway, in September 2013, Giorgio Borlenghi announced the Belfiore. This is a 46 unit 26-story luxury high-rise at the southeast corner of Post Oak Lane and South Wynden Drive. Uptown Houston is one of the most prestigious and desirable areas to live.

The economic picture is promising in Uptown. In 2013, the ad valorem values were up 20% from the previous year. There are new projects underway and Uptown remains a viable district. While economic factors (property values, vacancy rates, future development, etc.) impact the size of debt issues, management takes a conservative approach to ensure that adequate resources are available to support the projects.

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

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

STATEMENT OF NET POSITION - GOVERNMENTAL ACTIVITIES

June 30, 2013

Assets	
Cash	\$ 5,700,211
Property taxes receivable	139,188
Due from other governments	788,927
Other receivables	416,878
Prepaid expenses	75,954
Capital assets, net of depreciation	2,335,039
Total Assets	<u>9,456,197</u>
Deferred Outflows of Resources	
Deferred Charge on Refunding	269,096
Total deferred outflows of resources	<u>269,096</u>
Liabilities	
Accounts payable and accrued expenses	327,019
Due to Uptown Development Authority	510,549
Accrued interest	114,360
Long-term debt:	
Due in less than one year	665,000
Due in more than one year	9,904,809
Total liabilities	<u>11,521,737</u>
Net Position	
Net investment in capital assets	2,335,039
Restricted for debt service	1,133,738
Unrestricted	(5,265,221)
Total net position	<u>\$ (1,796,444)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES

For the Year Ended June 30, 2013

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue</u>		<u>Net (Expense)</u>
		<u>Charges</u>	<u>Capital</u>	<u>Revenue and</u>
		<u>for</u>	<u>Grants</u>	<u>Changes in</u>
		<u>Services</u>	<u>Grants</u>	<u>Net Position</u>
General and administrative	\$ 1,439,336	\$ 488,470	\$ -	\$ (950,866)
Traffic Control	1,695,642	-	-	(1,695,642)
Maintenance and beautification	1,572,812	124,384	-	(1,448,428)
Planning and engineering	476,204	-	413,142	(63,062)
Marketing and communication	329,584	-	-	(329,584)
Interest on long-term debt	584,071	-	-	(584,071)
Economic development	138,813	-	-	(138,813)
Construction on behalf of the City of Houston	-	316,500	3,075,961	3,392,461
Transfers to other governments - Uptown Development Authority	3,392,461	-	-	(3,392,461)
Total activities	<u>\$ 9,628,923</u>	<u>\$ 929,354</u>	<u>\$ 3,489,103</u>	<u>(5,210,466)</u>

General revenues:

Property taxes	5,251,213
Unrestricted investment earnings	12,949
Total general revenues and transfers	<u>5,264,162</u>
Change in net position	53,696
Net position - beginning	<u>(1,850,140)</u>
Net position - ending	<u>\$ (1,796,444)</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2013

	General Fund	Capital Projects	Debt Service	Total Governmental Funds
Assets				
Cash	\$ 4,398,852	\$ 139,534	\$ 1,161,826	\$ 5,700,212
Taxes receivable	90,198	-	48,990	139,188
Due from other funds	351,816	-	42,369	394,185
Due from other governments	278,378	510,549	-	788,927
Due from others	416,878	-	-	416,878
Prepaid items	75,954	-	-	75,954
Total assets	\$ 5,612,076	\$ 650,083	\$ 1,253,185	\$ 7,515,344
Liabilities and Deferred Inflows				
Liabilities:				
Accounts payable	\$ 321,933	\$ -	5,087	\$ 327,020
Due to other funds	-	394,185	-	394,185
Due to other governments	-	510,549	-	510,549
Total liabilities	321,933	904,734	5,087	1,231,754
Deferred Inflows of Resources				
Unavailable Revenues - Property Taxes	90,198	-	48,990	139,188
Total deferred inflows of resources	90,198	-	48,990	139,188
Fund balances:				
Restricted for:				
Nonspendable	75,954	-	-	75,954
Restricted	-	-	1,199,108	1,199,108
Unassigned	5,123,991	(254,651)	-	4,869,340
Total fund balances	5,199,945	(254,651)	1,199,108	6,144,402
Total liabilities and fund balances	\$ 5,612,076	\$ 650,083	\$ 1,253,185	\$ 7,515,344

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET POSITION

June 30, 2013

Total fund balance, governmental funds \$ 6,144,402

Amounts reported for governmental activities in the Statement of Net Position 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	\$ 15,143,017	
Less accumulated depreciation	<u>(12,807,978)</u>	
Difference due to capital assets		2,335,039

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	136,354	
Penalty and interest receivable	<u>2,834</u>	
Difference due to property taxes		139,188

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	(9,920,000)	
Loss on issue of refunding bond	269,096	
Unamortized premiums/discounts	(610,733)	
Accrued interest	(114,360)	
Amounts owed to developers	-	
Compensated absences	<u>(39,076)</u>	
Difference due to long-term obligations		<u>(10,415,073)</u>

Net Position of Governmental Activities in the Statement of Net Position **\$ (1,796,444)**

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

**STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS**

For the Year Ended June 30, 2013

	General Fund	Capital Projects	Debt Service	Total Governmental Funds
Revenues				
Property taxes	\$ 4,108,798	\$ -	\$ 1,141,001	\$ 5,249,799
Intergovernmental	488,470	3,075,961	-	3,564,431
Investment earnings	8,734	3,399	1,649	13,782
Other Income	537,526	316,500	-	854,026
Total revenues	<u>5,143,528</u>	<u>3,395,860</u>	<u>1,142,650</u>	<u>9,682,038</u>
Expenditures				
Current:				
Planning and engineering	476,204	-	-	476,204
Traffic control	999,616	-	-	999,616
Maintenance and beautification	1,572,812	-	-	1,572,812
General and administrative	1,424,043	-	-	1,424,043
Marketing and communications	327,084	-	-	327,084
Economic development	138,813	-	-	138,813
Debt Service:				
Principal	-	-	675,000	675,000
Interest and other charges	-	-	606,321	606,321
Capital Outlay	-	116,452	-	116,452
Transfers to other governments - Uptown Development Authority	-	3,392,461	-	3,392,461
Total expenditures	<u>4,938,572</u>	<u>3,508,913</u>	<u>1,281,321</u>	<u>9,728,806</u>
Excess (deficiency) of revenues over expenditures	<u>204,956</u>	<u>(113,053)</u>	<u>(138,671)</u>	<u>(46,768)</u>
Other Financing Sources/(Uses):				
Proceeds from long-term debt	-	-	9,910,733	9,910,733
Other use	-	-	(9,709,877)	(9,709,877)
Transfers in	-	73,536	-	73,536
Transfers out	(73,536)	-	-	(73,536)
Total other financing uses	<u>(73,536)</u>	<u>73,536</u>	<u>200,856</u>	<u>200,856</u>
Net change in fund balance	131,420	(39,517)	62,185	154,088
Fund balances - beginning of year	5,068,525	(215,134)	1,136,923	5,990,314
Fund balances - end of year	<u>\$ 5,199,945</u>	<u>\$ (254,651)</u>	<u>\$ 1,199,108</u>	<u>\$ 6,144,402</u>

See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 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, 2013

Net change in fund balances - total governmental funds: \$ 154,088

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. 1,414

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	\$ 116,452	
Depreciation expense	<u>(698,526)</u>	
Difference due to capital assets		(582,074)

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. 675,000

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:

Proceeds from issuance of refunding bond 2013	(9,910,733)	
Payment to Escrow agent on refunded bonds	9,709,877	
Increase in liability for compensated absences	(15,292)	
Interest expense accrual	<u>21,416</u>	
		(194,732)

Change in net position of governmental activities	<u><u>\$ 53,696</u></u>
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See notes to the Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS

June 30, 2013

A. 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 F 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 Position* 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 *(continued)*

A. 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, 2013, 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 (continued)

A. 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 Balance / Restricted Assets

The District records reservations for all or portions of governmental fund balances which are legally segregated for specific future use or which do not represent available spendable resources and therefore not available for appropriation. Unassigned fund balance indicates the portion of fund balance which is available for appropriation in future periods. The restricted fund balances for governmental funds represent the amount that has been identified for specific purposes.

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

Beginning with fiscal year 2011, the District implemented GASB Statement No. 54 “Fund Balance Reporting and Governmental Fund Type Definitions.” This Statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on a government’s fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

Nonspendable fund balance – amounts that are not in spendable form or are required to be maintained intact. As such, the inventory and prepaid items have been properly classified in the Governmental Funds Balance Sheet.

Restricted fund balance – Amounts that can be spent only for specific purposes because of local, state or federal laws, or externally imposed conditions by grantors or creditors.

Committed fund balance – amounts constrained to specific purposes by the District itself, using its highest level of decision-making authority (i.e. the Board of Directors). To be reported as committed, amounts cannot be used for any other purposes unless the District takes the same highest level of action to remove or change the constraint.

Assigned fund balance – amounts the District intends to use for a specific purpose. Intent can be expressed by the Authority or by an official or body to which the Board of Directors delegates the authority. Funds maybe be assigned by the District’s president or by the Board of Directors for specific purposes through the budget process or agenda items.

Unassigned fund balance – amounts that are available for any purpose. Positive amounts are reported only in the general fund.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

A. Summary of Significant Accounting Policies - continued

Fund Balance / Restricted Assets - continued

The District establishes (and modifies or rescinds) fund balance commitments by passage of a resolution. When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds. The District has nonspendable, restricted and unassigned fund balances as of June 30, 2013.

Deferred outflows/inflows of resources

Effective June 30, 2013, the District implemented GASB Statement No. 63 *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* as well as GASB Statement No. 65 *Items Previously Reported as Assets and Liabilities*. GASB Statement No. 63 provides guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. As a result, the term “net assets” (a residual measure) has been renamed to “net position”. Furthermore, the objective of GASB Statement No. 65 is to either (a) properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources or (b) recognize certain items that were previously reported as assets and liabilities as outflows of resources (expenses or expenditures) or inflows of resources (revenues). These determinations are based on the definitions of those elements in Concepts Statement No. 4, *Elements of Financial Statements*.

With the implementation of these two statements, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/ expenditure) until then. The District only has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the government-wide statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

	Previous Balance	Current Year	Year End Balance
Refunding difference 2004 Issue	\$ 80,264	\$ (16,054)	\$ 64,210
Refunding difference 2013 Issue	-	204,886	204,886
	\$ 80,264	\$ 188,832	\$ 269,096

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

A. Summary of Significant Accounting Policies - continued

Deferred outflows/inflows of resources - continued

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The District has unavailable property taxes including penalty and interest of \$139,188 that qualifies for reporting in this category, which arise only under a modified accrual basis of accounting.

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 position*.

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.

B. Deposits and Investments

As of June 30, 2013, the District's cash was comprised of the following:

	Carrying Value
Demand deposits	\$ 661,368
Money market funds	5,038,844
	<u>\$ 5,700,212</u>

As of June 30, 2013, the District had no investments.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

B. Deposits and Investments - continued

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.

C. Capital Assets

A summary of changes in capital assets, for the year ended June 30, 2013, follows:

	Beginning Balance	Additions	Ending Balance
Capital assets being depreciated:			
Machinery and equipment	\$ 15,026,565	\$ 116,452	\$ 15,143,017
Less accumulated depreciation	<u>(12,109,452)</u>	<u>(698,526)</u>	<u>(12,807,978)</u>
Capital assets, net	<u>\$ 2,917,113</u>	<u>\$ (582,074)</u>	<u>\$ 2,335,039</u>

Depreciation was charged to functions of the District as follows:

Traffic control	\$ 698,526
	<u>\$ 698,526</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

D. Long-Term Liabilities

As of June 30, 2013, the District's long-term liabilities were comprised of the following:

	Balance	Due Within One Year
Bonds payable	\$ 9,920,000	\$ 665,000
Unamortized premium	610,733	-
Compensated absences	39,076	-
	\$ 10,569,809	\$ 665,000

During the year, the District's long-term liabilities changed as outlined below. In the fiscal year, the District issued 2013 Refunding Bonds, refunding a portion of 1999 and the 2004 issues. An economic gain of \$972,294 resulted. Interest cost of 2.11 percent. The District paid \$200,856 in issue costs. The reacquisition price exceeded the net carrying amount of the old debt by \$204,886. This resulting deferred outflow is amortized over the life of the new debt.

	Beginning Balance	Additions	Reductions	Ending Balance
Unlimited tax bonds	\$ 10,835,000	\$ 9,300,000	\$ (10,215,000)	\$ 9,920,000
Unamortized discounts	(35,009)	-	35,009	-
Unamortized premiums	-	610,733	-	610,733
Compensated absences	23,784	15,292	-	39,076
	\$ 10,823,775	\$ 9,926,025	\$ (10,179,991)	\$ 10,569,809

Compensated Absences

Beginning Balance	\$ 23,784
Additions	15,292
Payments	-
Ending Balance	\$ 39,076

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

D. Long-Term Liabilities - continued

Bonds payable consist of the following:

Series	Amount Outstanding	Original Issue	Interest Rate
Unlimited Tax Improvement and Refunding Bonds, Series 2004	\$ 620,000	\$ 13,635,000	2.00%-5.00%
Refunding Bonds, Series 2013	9,300,000	9,300,000	1.875%-4.00%
Total	<u><u>\$ 9,920,000</u></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
2014	\$ 665,000	\$ 314,745	\$ 979,745
2015	750,000	289,375	1,039,375
2016	795,000	258,475	1,053,475
2017	840,000	228,750	1,068,750
2018	880,000	202,663	1,082,663
2019	915,000	176,675	1,091,675
2020	950,000	148,700	1,098,700
2021	990,000	119,600	1,109,600
2022	1,020,000	89,450	1,109,450
2023	1,045,000	58,475	1,103,475
2024	1,070,000	21,400	1,091,400
	<u><u>\$ 9,920,000</u></u>	<u><u>\$ 1,908,308</u></u>	<u><u>\$ 11,828,308</u></u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

D. Long-Term Liabilities – continued

A summary of District Bonds authorized, but unissued at June 30, 2013 follows:

<u>Purpose</u>	<u>Date Authorized</u>	<u>Amount Authorized</u>	<u>Amount 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>

E. 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 1 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 31. There is an additional 15% penalty charged on accounts delinquent after July 1, 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, 2013, was financed through the 2012 tax levy. The District levied property taxes of \$0.1435 per \$100 of assessed value, of which \$0.1123 was allocated to maintenance and operations and \$0.0312 was allocated to debt service. The resulting tax levy was \$5,259,843 on the adjusted taxable value of \$3,665,395,986.

Taxes receivable, at June 30, 2013, consisted of the following:

Current year taxes receivable	\$ 15,697
Delinquent taxes receivable	120,657
	<u>136,354</u>
Penalty and interest receivable	2,834
Total property taxes receivable	<u>\$ 139,188</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

F. Significant Legal Provisions of Legislative Act Creating District

As discussed in Note A 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. On May 22, 2013, Harris County Improvement District No. 1 adopted an Order Adding Land (responding to a petition of the landowners) adding 33.99 acres of land (located in the vicinity of the intersection of US 59 and IH 610) to the District.

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.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS (continued)

F. Significant Legal Provisions of Legislative Act Creating District – continued

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.

G. Operating Agreement - Uptown Development Authority

The District has entered into an operating agreement with Uptown Development Authority (the “Authority”). The Authority is a component unit of the City of Houston formed to carry on improvements in the Uptown Houston area. The governing boards of both the District and the Authority 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 services as and when requested by the Authority Board. The services may consist of general administrative support, project management and development, consultant management, and other services as may be deemed necessary. The District is the recipient of federal grants for pedestrian and intersection improvements within the District. Additionally, the Authority has an approved capital improvement plan which includes pedestrian and intersection improvements. These two entities will work in conjunction with the Authority providing the local match and the implementation of the project while the District will provide the grant funds (see Note K). Financial information regarding the Authority can be obtained from Uptown Development Authority, 1980 Post Oak Boulevard #1580, Houston, Texas 77056.

Financing Agreement - Uptown Development Authority

The District has a Finance Agreement with the Uptown Development Authority (The UDA) in which the Authority could borrow up to \$3.5 million, which is to be repaid by the Authority’s fiscal year-end (June 30, 2013). While this agreement is still in place, the Authority did not make use of requesting funds from the District. This agreement is reviewed and approved annually by both Boards of Directors.

H. 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, 2013, the District contributed \$74,800 to the plan.

I. 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.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

J. Budget Overages

The Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget to Actual presents budget overages in certain expenditures. Planning and Engineering expenditures exceeded budget due to the second phase of the terminal planning being initiated, however it was not budgeted to start in the fiscal period. This project does have grant funding offsetting the costs. Traffic Control actual expenditures exceeded budget due to the transition of the officers from 1099 vendors to part-time W-2 employees. The additional payroll costs and insurance requirements account for the cost increase. Economic Development costs exceeded budget by 14% primarily due to consultant costs incurred to create an economic database/repository.

K. Deficit Fund Balance

A deficit fund balance of (\$254,651) exists in the Capital Projects fund as of June 30, 2013. The deficit fund balance is primarily a result of previous transfers from the operating fund to cover project design costs during that period. The issuance of new debt will resolve the deficit.

L. 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, 2013, the District received \$455,215 from the TIRZ for reimbursement of administration costs, project management costs and traffic and mobility costs.

M. Federal Grants

The District is a recipient of two Federal grants for pedestrian and intersection improvements: Congestion Mitigation and Air Quality (CMAQ) 80/20 Grant and American Recovery and Reinvestment Act (ARRA) Grant (100 percent funded) and a Congressional appropriated Discretionary Grant. The District passes the proceeds of these grants 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 CMAQ 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 (continued)

M. Federal Grants – continued

A summary of grant activity through June 30, 2013, is shown below along with similar information for the total grant.

<u>Funding Source</u>	<u>Amounts</u>	
	<u>Actual through June 30, 2013</u>	<u>Total Grant</u>
Congestion Mitigation Air Quality Federal (CMAQ) Grant (80%)	\$ 10,063,400	\$ 15,124,994
American Recovery and Reinvestment Act Grant (100%)	5,000,000	5,000,000
Congressional Appropriated Discretionary Grant	894,397	2,665,864
	<u>\$ 15,063,400</u>	<u>\$ 22,790,858</u>

The CMAQ grant requires a 20 percent match, which is made by the UDA. For the cumulative period ending June 30, 2013, the UDA provided the required local match of \$558,582.

N. Subsequent Events

Management has evaluated subsequent events through December 11, 2013, which is the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - BUDGET TO ACTUAL**

June 30, 2013

	Original Budget	Final Budget	Actual	Variance with Final Budget Positive/ (Negative)
Revenues				
Property taxes	\$ 3,788,133	\$ 3,788,133	\$ 4,108,798	\$ 320,665
Intergovernmental	455,207	455,207	455,207	-
Shelter program	33,263	33,263	33,263	-
Investment earnings	26,897	26,897	8,734	(18,163)
HGAC Grants	5,100,000	5,100,000	3,075,961	(2,024,039)
Miscellaneous	-	-	537,526	537,526
Total revenues	9,403,500	9,403,500	8,219,489	(1,184,011)
Expenditures				
Current:				
Planning and engineering	160,000	160,000	476,204	(316,204)
Traffic control	878,000	878,000	999,616	(121,616)
Maintenance and beautification	1,530,200	1,530,200	1,572,812	(42,612)
General and administrative	1,398,300	1,398,300	1,424,043	(25,743)
Marketing and communications	315,000	315,000	327,084	(12,084)
Economic development	122,000	122,000	138,813	(16,813)
Transfer of HGAC Grants to UDA	5,000,000	5,000,000	3,075,961	1,924,039
Total expenditures	9,403,500	9,403,500	8,014,533	1,388,967
Excess (deficiency) of revenues over expenditures	-	-	204,956	(204,956)
Other Financing Sources (Uses)				
Transfers in				
Transfers out - Capital Fund	-	-	(73,536)	73,536
Total other financing sources (uses)	-	-	(73,536)	73,536
Net change in fund balance	-	-	131,420	(131,420)
Fund balances - beginning of year	5,068,525	5,068,525	5,068,525	-
Fund balances - end of year	\$ 5,068,525	\$ 5,068,525	\$ 5,199,945	\$ (131,420)

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

**RECONCILIATION TO SCHEDULE OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE - GENERAL FUND**

June 30, 2013

Excess of revenues over expenditures	\$ 204,956
Less: Transfers Out	(73,536)
Net Change in Fund Balance	<u>131,420</u>
Fund balance, beginning of year	<u>5,068,525</u>
Fund balance, end of year	<u><u>\$ 5,199,945</u></u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2013

Budgets and Budgetary Accounting

A non-appropriated budget is adopted for the General Fund by the District's Board of Directors. The budget is considered a planning tool and does not constitute legal spending limit authority. The budget is prepared using the same method of accounting as for the financial reporting except that the General Fund budget includes federal grant revenues and the related transfers. For financial reporting purposes, the federal grant revenues and the related transfers are reported in the Capital Projects Fund. There were no amendments to the budget.