

**NORTH HARRIS COUNTY REGIONAL
WATER AUTHORITY**

FINANCIAL STATEMENTS

December 31, 2009 and 2008

McGrath & Co., PLLC

Certified Public Accountants

P.O. Box 270148
Houston, Texas 77277

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**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
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Independent Auditors' Report

Board of Directors
North Harris County Regional Water Authority

We have audited the accompanying statements of net assets of the business type activities of North Harris County Regional Water Authority (the "Authority"), as of December 31, 2009 and 2008, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority, as of December 31, 2009 and 2008, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Our audits were conducted for the purpose of forming an opinion on the Authority's basic financial statements. The information beginning on page 42 appears as supplementary information. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However we did not audit the information and express no opinion on it.



Houston, Texas
May 3, 2010

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Management's Discussion and Analysis

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***North Harris County Regional Water Authority
Management's Discussion and Analysis
December 31, 2009***

Using this Annual Report

Within this section of the financial report of the North Harris County Regional Water Authority (the "Authority"), the Authority's Management provides narrative discussion and analysis of the financial activities of the Authority, for the fiscal years ended December 31, 2009 and 2008. This analysis should be read in conjunction with the basic financial statements that follow this section.

In addition to this discussion and analysis, this annual report consists of:

- The Authority's basic financial statements;
- Notes to the basic financial statements; and
- Additional supplementary information

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements, which are comprised of the following: 1) *Statement of Net Assets*, 2) *Statement of Revenues, Expenses and Changes in Net Assets*, and the 3) *Statement of Cash Flows*. This report also contains supplementary information in addition to the basic financial statements themselves.

The *Statement of Net Assets* presents information on all of the Authority'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 of changes in the financial position of the Authority.

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the Authority'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 the 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 (e.g., earned but unused vacation leave).

The *Statement of Cash Flows* presents information on the Authority's cash inflows and outflows during the fiscal year. Cash flows are categorized as operating activities; capital and related financing activities and investing activities. This statement includes a reconciliation of cash provided by the Authority's operating activities to operating income as reported on the *Statement of Revenues, Expenses and Changes in Net Assets*.

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

Financial Analysis of the Authority

On the *Statement of Net Assets*, the difference between assets and liabilities is called net assets. The Authority's net assets at December 31, 2009 and 2008, were \$32,980,604 and \$18,638,021, respectively. Net assets are categorized based on their availability to provide financial resources for the Authority. Net assets that are "Invested in capital assets, net of related debt" represent the Authority'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 Authority's future obligations.

**North Harris County Regional Water Authority
Management's Discussion and Analysis
December 31, 2009**

Financial Analysis of the Authority (continued)

The Authority's overall financial position at December 31, 2009 as compared to the two prior years is summarized as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current and other assets	\$ 234,360,073	\$ 335,731,527	\$ 106,620,907
Capital assets	349,891,998	233,607,294	184,042,781
Total assets	<u>584,252,071</u>	<u>569,338,821</u>	<u>290,663,688</u>
Current liabilities	8,033,492	2,294,925	1,052,110
Long term liabilities	543,237,975	548,405,875	276,417,088
Total liabilities	<u>551,271,467</u>	<u>550,700,800</u>	<u>277,469,198</u>
Net Assets			
Invested in capital assets, net of related debt	(86,486,484)	(86,933,362)	(41,617,071)
Restricted for debt service	52,328,740	57,446,477	5,190,910
Unrestricted	<u>67,138,348</u>	<u>48,124,906</u>	<u>49,620,651</u>
Total net assets	<u>\$ 32,980,604</u>	<u>\$ 18,638,021</u>	<u>\$ 13,194,490</u>

The Authority's net operating income for the year ended December 31, 2009 was \$34,304,912 with net non-operating expenses of \$19,962,329 resulted in an increase in net assets of \$14,342,583. The Authority's net operating income for the year ended December 31, 2008 was \$18,887,893 with net non-operating expenses of \$13,444,362 resulted in an increase in net assets of \$5,443,531. Non-operating revenues and non-operating expenses represented interest income from the Authority's investments and interest expense from the Authority's debt. The increase in net assets in 2009 was primarily the result of an increase in the pumpage fees, which was effective January 1, 2009, and unusually dry conditions during the year which increased the volume of water pumped. The increase in net assets in 2008 was primarily the result of an increase in pumpage fees. The rate increases are consistent with the Authority's financial planning and budgeting, and are used to satisfy bond covenants and debt service requirements.

A summarized comparison of the Authority's operations for the year ended December 31, 2009 with the previous two years is as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues	\$ 46,660,076	\$ 28,394,551	\$ 20,748,512
Operating expenses	<u>(12,355,164)</u>	<u>(9,506,658)</u>	<u>(8,502,282)</u>
Net operating income	34,304,912	18,887,893	12,246,230
Net non-operating revenue (expense)	<u>(19,962,329)</u>	<u>(13,444,362)</u>	<u>(7,381,550)</u>
Change in net assets	14,342,583	5,443,531	4,864,680
Net assets, beginning of year	<u>18,638,021</u>	<u>13,194,490</u>	<u>8,329,810</u>
Net assets, end of year	<u>\$ 32,980,604</u>	<u>\$ 18,638,021</u>	<u>\$ 13,194,490</u>

**North Harris County Regional Water Authority
Management's Discussion and Analysis
December 31, 2009**

Capital Assets

As of December 31, 2009, the Authority had invested \$349,891,998 (net of accumulated depreciation) in capital assets. These capital assets primarily consist of land, construction in progress, infrastructure and the Authority's interest in treated water facilities and water transmission facilities.

The Authority's capital assets at December 31, 2009, as compared to the two previous years are summarized as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital assets not being depreciated:			
Land and ROW acquisition	\$ 18,897,704	\$ 16,744,457	\$ 13,539,105
Construction in progress	90,425,276	57,161,235	23,636,984
Non-depreciable capital assets	<u>109,322,980</u>	<u>73,905,692</u>	<u>37,176,089</u>
Capital assets being depreciated or amortized:			
Interest in treated water facilities	75,853,800	52,454,277	52,454,277
Interest in transmission facilities	26,064,086	26,064,086	26,064,086
Infrastructure	157,203,517	94,648,148	77,978,492
Furniture, computers & equipment	153,361	141,361	141,361
	<u>259,274,764</u>	<u>173,307,872</u>	<u>156,638,216</u>
Less accumulated depreciation and amortization for:			
Interest in treated water facilities	(9,072,304)	(7,122,998)	(5,814,312)
Interest in transmission facilities	(2,322,346)	(1,742,327)	(1,162,310)
Infrastructure	(7,170,493)	(4,604,290)	(2,662,271)
Furniture, computers & equipment	(140,603)	(136,655)	(132,631)
Total accumulated depreciation and amortization	<u>(18,705,746)</u>	<u>(13,606,270)</u>	<u>(9,771,524)</u>
Depreciable capital assets, net	240,569,018	159,701,602	146,866,692
Total capital assets, net	<u>\$ 349,891,998</u>	<u>\$ 233,607,294</u>	<u>\$ 184,042,781</u>

During the current year, the Authority completed capital projects in the amount of \$124,181,903, which primarily consist of the following:

- Land and ROW acquisitions
- 54-inch waterline along CenterPoint easement (Project 16)
- District connections – Contract 2 (Project 7C4-2)
- 60-inch waterline along future TC Jester (Project 17-4)
- 54-inch waterline along Spears and West Rankin Road from River Laurel to Harris County Flood Control District – Unit P14000 (Project 17-2)
- 12-inch and 16-inch waterline connections and various groundwater plant conversions (Project 1A3-2)
- 24/20-inch waterline from TC Jester to Ella Blvd. and 16-inch connections to Ponderosa Forest Utility District and 12-inch connection to Bammel Forest Utility District (Project 11)
- 20-inch waterline along Red Oak Dr., Timor Lane and the CenterPoint Energy easement and 12-inch water line connection to CNP Utility District water plant (Project 14B)

Capital Assets (continued)

- Waterline along Prestonwood Forest subdivision and Cypresswod Dr. (Project 4C)
- 12-inch and 16-inch waterline connections and various groundwater plant conversions (Project 1A3-1)
- 16-inch and 30-inch water transmission line to serve Harris County MUD No. 367 and 368 (Project 6A-1)
- Waterline along Grant Rd. and Louetta Rd. (Project 6B-2)
- 30-inch and 60-inch waterlines along CenterPoint Energy (Project 7C-3)
- 30-inch waterline along Bourgeois Rd. and West Richey Rd. and 16-inch waterline to Northwest Harris County MUD No. 6 (Project 15B)

The projects that are not complete as of fiscal year end, along with related engineering fees, have been recorded as construction in progress in the *Statement of Net Assets*. Engineering fees related to various other projects that are in the preliminary phases have also been recorded as construction in progress in the *Statement of Net Assets*.

Construction in progress includes the following projects:

- Ground storage tanks, yard piping and storm water drainage (Project 2, Package 1)
- 54-inch waterline from Greens Road to West Rankin Road (Project 17)
- 30-inch waterline along Cypresswood Drive and Mirror Lake, 54-inch waterline from Greens Road to West Rankin Road (Project 14-A)
- Construction of Spears Road pump station (Project 2, Package 2)
- Louetta Regional Water Plant pump station (Project 5D)
- Water distribution system service connections to water plants at Faulky Gully MUD, Grant Road PUD, Harris County MUD No. 18 and Northwest Harris County MUD No. 5 (Project 6B-3)
- 60-inch, 20-inch, 16-inch and 12-inch waterlines (Project 17, Segment 3)
- 16-inch waterline along Centerpoint Energy (Project 7C-3, Part 2)
- 30-inch waterline along the Kinder Morgan Pipeline easement between Project 7B and Northwest Harris County MUD No. 36 (Project 7C-6)
- 16-inch water transmission lines to serve Harris County MUD No. 24 and Harris County WCID No. 114 along Theiss Gully and Stuebner Airline Drive (Project 7C-6)
- District connections – Contract 1 (Project 7C-4)
- 42-inch water main - T.C. Jester and 20-inch waterline – Cypresswood (Project 10B)

**North Harris County Regional Water Authority
Management's Discussion and Analysis
December 31, 2009**

Long-Term Obligations

The Authority's total long term obligations at December 31, 2009, as compared to the previous two years is as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital contributions			
2003	\$ 32,573,177	\$ 32,573,177	\$ 32,573,177
2005	14,675,978	14,675,978	14,675,978
2008	<u>35,896,880</u>	<u>30,010,202</u>	<u>30,010,202</u>
	<u>83,146,035</u>	<u>77,259,357</u>	<u>47,249,155</u>
Revenue bonds			
Series 2003	124,685,000	124,685,000	124,685,000
Series 2005	93,875,000	93,875,000	93,875,000
Series 2008	238,115,000	238,115,000	238,115,000
Unamortized bond premium	7,473,926	7,769,921	8,065,916
Unamortized bond discount	<u>(3,453,377)</u>	<u>(3,583,043)</u>	<u>(1,660,560)</u>
	<u>460,695,549</u>	<u>460,861,878</u>	<u>224,965,356</u>
Accrued compensated absences	<u>140,681</u>	<u>133,957</u>	<u>133,564</u>
	<u>\$ 543,982,265</u>	<u>\$ 538,255,192</u>	<u>\$ 272,348,075</u>

During the current fiscal year, the Authority received \$5,886,678 in additional 2008 capital contributions.

The revenue bonds are secured by a pledge on the Authority's net revenues (total revenues less operating and maintenance costs). As further discussed in Note 5, the Authority's master resolution requires that the Authority maintain balances in the following funds: (1) interest and sinking fund, (2) reserve fund, (3) coverage fund, (4) operation and maintenance fund and (5) improvement fund. During 2009, the Authority has continued to comply with all of its bonds covenants and has maintained these funds at required levels. In addition, the Authority transferred \$16,000,000 to the improvement fund. There was no change in the Authority's bond ratings during the year.

Next Year's Budget

The Authority's 2010 budget as compared to actual results for 2009 is as follows:

	<u>2009 Actual</u>	<u>2010 budget</u>
Operating revenues	\$ 46,660,076	\$ 43,708,919
Operating expenses	<u>(12,355,164)</u>	<u>(16,950,173)</u>
Net operating income	<u>34,304,912</u>	<u>26,758,746</u>
Interest revenues	2,016,521	950,000
Interest expense	<u>(21,978,850)</u>	<u>(21,222,471)</u>
Net non-operating expense	<u>(19,962,329)</u>	<u>(20,272,471)</u>
Change in net assets	14,342,583	6,486,275
Beginning net assets	<u>18,638,021</u>	<u>32,980,604</u>
Ending net assets	<u>\$ 32,980,604</u>	<u>\$ 39,466,879</u>

Next Year's Budget (continued)

As previously discussed, 2009 actual revenues were higher than anticipated due to unusually dry conditions during the year. Accordingly, the Authority's budgeted revenues for 2010 are less than 2009 actual amounts. The increase in budgeted expenses for 2010 is primarily attributed to higher anticipated operations and maintenance costs.

Economic Factors

The Harris-Galveston Subsidence District (HGSD) groundwater reduction requirements mandate that construction will begin on the infrastructure required to meet the 2010 conversion target of thirty percent reduction in groundwater use, along with requirements for higher conversion target thresholds which will take effect through the year 2030. The Authority's approved Groundwater Reduction Plan (GRP) defines how it will comply with this requirement.

As the GRP was being developed, it became apparent that some water districts within the Authority were experiencing difficulty with either the water quality or water quantity to meet accelerating demand. These districts would soon be forced to decide whether or not to drill a new well, sometimes at a cost of more than a million dollars, which may be minimally used once the area converted to surface water in 2010.

From the outset, the Authority's cornerstone precept was fairness and equity among all users within its boundaries, and promised that the overall cost of accommodating the HGSD mandate would be shared by everyone. Drilling new wells that were not ideally positioned to be incorporated into the long-term distribution system or would be minimally used upon conversion to surface water was clearly not cost-effective. Recognizing this, the Authority initiated the Groundwater Transfer Program (the "GTP") to share existing groundwater supplies by 'connecting' the districts that had surplus capacity in their wells with the ones that needed additional water immediately. The GTP involved constructing portions of the 2010 distribution lines significantly earlier than originally planned. The necessary components of the GTP were completed and the GTP was placed in operation in January 2006.

In October 2003, the Authority adopted its first Capital Improvement Plan (the 2004-2005 "CIP"). The primary focus of the first CIP was the definition and construction of the infrastructure necessary to allow implementation of the GTP. Subsequent plans expanded on this foundation by outlining and implementing a broad-based program to provide the remainder of the infrastructure necessary to comply with the initial conversion to surface water in 2010. The 2009-2010 CIP continued and completed that program. Additionally, the 2009-2010 CIP provided for refining the infrastructure needed to meet the HGSD 2020 mandate and initiation of efforts to secure and/or construct those facilities.

The 2010-2011 CIP continues the systematic planning and development process begun when the Authority's Board adopted the first CIP in 2003. The primary focus of the Plan is to: 1) facilitate the conversion to surface water in 2010; and, 2) refine the infrastructure needed to continue implementation of the GRP in 2020 and to initiate efforts to provide that infrastructure.

Economic Factors (continued)

Significant activities addressed in the Plan are:

- Continue evaluation of the need for regional water wells; and, as need is defined, locate, purchase or design and construct these wells
- Continue and complete the development of the Supervisory Control and Data Acquisition (“SCADA”) System to enable efficient operation of the 2010 system
- Provide infrastructure to areas adjacent to the 2010 service area to enable the phased implementation of the 2020 distribution system
- Finalize the alignment of the portion of the 2020 transmission line, which lies generally north of Beltway 8 from just east of Highway 59 to State Highway 249, and initiate securing the necessary easements
- Identify and purchase the site for each of the three 2020 regional water plants and two 2020 regional pump stations
- Pay the final component of the capital cost for the 31 million gallons per day (“MGD”) allocation of water from the City of Houston and funds to increase the Authority’s allocation up to 36 MGD
- Provide funding to purchase an additional 6 MGD capacity in the Greens Road waterline
- Pay the Authority’s portion of the right-of-way and related costs for the Luce Bayou Interbasin Diversion project
- Reuse program participation
- Provide professional services to perform a wide variety of activities required to implement the CIP

The Plan has been developed using the best, currently available information about the scope of each project along with cost experience from the Authority’s projects completed to date. While the Authority’s body of empirical cost data is expanding, especially in terms of water lines, the cost base is still evolving in several areas. Accordingly, the following points are offered to help keep the implementation of the 2010-2011 CIP in perspective:

- It is possible that conditions would evolve on a project that could materially impact the cost of the project
- Real estate and construction costs can be and are influenced by variables over which the Authority has no control
- It is common to experience unexpected costs in the implementation of a CIP. Provision of a contingency is the most practical way to attempt to address this issue

While the 2004-2005 CIP used the best cost estimation available at the time, it did not have the benefit of building upon actual Authority project experience; instead, the costing was based on the general project definition presented in the GRP. As the actual design of the projects proceeded and the criteria within which the Authority needed to develop its projects became clearer, it has become possible to sharpen the definition of the projects. As a result, the ability to estimate the project costs has improved. The estimated costs included in the Plan have been updated and/or based, wherever possible or practical, on experience gained thus far on actual Authority projects.

**North Harris County Regional Water Authority
Management's Discussion and Analysis
December 31, 2009**

Economic Factors (continued)

The proceeds from the Authority's Series 2003, 2005 and 2008 Senior Lien Revenue Bonds, capital contributions and interest earned (collectively called "Revenue Bonds") total approximately \$429 million. As seen on the following table, approximately \$103 million of those Revenue Bonds will be used to implement the Plan.

Category	Authorizations		Fiscal Year		Project Total
	1/1/03-9/30/09	10/1/09-12/31/09	Planned Authorizations		
			2010	2011	
Acquisition	\$ 23,023,000	\$	\$ 16,619,000	\$ 6,777,000	\$ 46,419,000
Design	38,382,000	4,718,000	11,146,000	5,476,000	59,722,000
Construction	232,014,000	3,891,000	5,622,000	5,990,000	247,517,000
Other	32,507,000	18,283,000	19,625,000	4,750,000	75,165,000
Total Authorizations	\$ 325,926,000	\$ 26,892,000	\$ 53,012,000	\$ 22,993,000	\$ 428,823,000
Source of Funds					
Revenue Bonds	\$ 325,926,000	\$ 26,892,000	\$ 53,012,000	\$ 22,993,000	\$ 428,823,000

Through September, 2008, approximately 76 percent of the Revenue Bonds earmarked for the implementation of the CIP have been authorized (encumbered). The Plan schedules the remainder of those funds to be authorized by the end of 2011.

Request for Information

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any information provided in this report or requests for additional information should be addressed to the Financial Assistant, North Harris County Regional Water Authority, 3648 FM 1960 West, Suite 110, Houston, Texas 77068.

Basic Financial Statements

*North Harris County Regional Water Authority
Statements of Net Assets
December 31, 2009 and 2008*

	<u>2009</u>	<u>2008</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 23,210,614	\$ 44,634,390
Investments	40,387,441	
Accrued interest receivable	353,198	
Other receivables	427,662	446,526
Total current assets	<u>64,378,915</u>	<u>45,080,916</u>
Noncurrent assets		
Restricted cash and cash equivalents	36,917,682	286,221,311
Restricted investments	128,800,051	
Bond issuance costs, net	4,263,425	4,429,300
Capital assets not being depreciated	109,322,980	73,905,692
Capital assets net of accumulated depreciation	<u>240,569,018</u>	<u>159,701,602</u>
Total noncurrent assets	<u>519,873,156</u>	<u>524,257,905</u>
Total assets	<u>584,252,071</u>	<u>569,338,821</u>
Liabilities		
Current liabilities		
Accounts payable	450,030	416,744
Other payables	5,264	5,264
Due to other governments	908,017	829,345
Interest payable on bonds	1,043,572	1,043,572
Capital contributions, due within one year	1,021,609	
Bonds payable, due within one year	<u>4,605,000</u>	
Total current liabilities	<u>8,033,492</u>	<u>2,294,925</u>
Noncurrent liabilities		
Accounts payable from restricted assets	3,099,149	8,424,132
Retainage payable from restricted assets	1,783,171	1,726,551
Accrued compensated absences	140,681	133,957
Capital contributions due in more than one year	82,124,426	77,259,357
Bonds payable due in more than one year (net of unamortized bond premium and discount)	<u>456,090,548</u>	<u>460,861,878</u>
Total noncurrent liabilities	<u>543,237,975</u>	<u>548,405,875</u>
Total liabilities	<u>551,271,467</u>	<u>550,700,800</u>
Net assets		
Invested in capital assets, net of related debt	(86,486,484)	(86,933,362)
Restricted for debt service	52,328,740	57,446,477
Unrestricted	<u>67,138,348</u>	<u>48,124,906</u>
Total net assets	<u>\$ 32,980,604</u>	<u>\$ 18,638,021</u>

See Notes to Financial Statements.

*North Harris County Regional Water Authority
 Statements of Revenues, Expenses and Changes in Net Assets
 For the Years Ended December 31, 2009 and 2008*

	<u>2009</u>	<u>2008</u>
Operating revenues		
Charges for services		
Pumpage fees	\$ 44,639,431	\$ 26,969,345
Water sales	1,998,546	1,389,056
Other	22,099	36,150
Total operating revenues	<u>46,660,076</u>	<u>28,394,551</u>
Operating expenses		
Personnel	1,260,883	1,191,906
Professional fees	1,601,339	1,537,571
Purchased water	2,870,250	1,483,685
Contracted services	452,724	500,799
Occupancy and office	638,518	551,982
Other	264,598	259,397
Depreciation and amortization	5,266,852	3,981,318
Total operating expenses	<u>12,355,164</u>	<u>9,506,658</u>
Net operating income	34,304,912	18,887,893
Non-operating revenues (expenses)		
Interest and fiscal fees	(21,978,850)	(17,476,739)
Investment income	2,016,521	4,032,377
Net non-operating revenues (expenses)	<u>(19,962,329)</u>	<u>(13,444,362)</u>
Change in net assets	14,342,583	5,443,531
Total net assets - beginning	<u>18,638,021</u>	<u>13,194,490</u>
Total net assets - ending	<u>\$ 32,980,604</u>	<u>\$ 18,638,021</u>

See Notes to Financial Statements.

North Harris County Regional Water Authority
Statements of Cash Flows
For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities		
Receipts from customers	\$ 42,584,363	\$ 25,755,589
Payments for personnel costs	(1,892,677)	(1,191,513)
Payments to contractors and vendors	(5,155,625)	(4,472,222)
Net cash provided by operating activities	<u>35,536,061</u>	<u>20,091,854</u>
Cash flows from capital and related financing activities		
Interest paid	(23,538,080)	(14,783,795)
Acquisition and construction of capital assets	(121,087,891)	(46,488,244)
Proceeds from issuance of debt		238,115,000
Bond issuance costs		(935,593)
Bond discount		(2,007,538)
Refund received from City of Houston		3,123,067
Capital contributions	5,886,678	30,010,202
Net cash provided (used) by capital and related financing activities	<u>(138,739,293)</u>	<u>207,033,099</u>
Cash flows from investing activities		
Interest received	2,957,560	4,032,377
Payments for investments	(401,102,688)	
Receipts from investment sales and maturities	230,620,955	
Net cash provided by investing activities	<u>(167,524,173)</u>	<u>4,032,377</u>
Net increase (decrease) in cash and cash equivalents	(270,727,405)	231,157,330
Balances -beginning of the year	<u>330,855,701</u>	<u>99,698,371</u>
Balances - end of the year	<u>\$ 60,128,296</u>	<u>\$ 330,855,701</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 34,304,912	\$ 18,887,893
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	5,266,852	3,981,318
Non-cash revenue from capital contribution credit	(4,094,577)	(2,353,126)
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	18,864	(285,836)
Increase (decrease) in accounts payable	33,286	(138,788)
Increase (decrease) in compensated absences	6,724	393
Total adjustments	<u>1,231,149</u>	<u>1,203,961</u>
Net cash provided by operating activities	<u>\$ 35,536,061</u>	<u>\$ 20,091,854</u>
Cash and cash equivalents per balance sheet:		
Cash and cash equivalents	23,210,614	\$ 44,634,390
Restricted cash and cash equivalents	36,917,682	286,221,311
	<u>\$ 60,128,296</u>	<u>\$ 330,855,701</u>

See Notes to Financial Statements.

Note 1- Summary of Significant Accounting Policies

The North Harris County Regional Water Authority (the “Authority”) was created in 1999 under Article 16, Section 59 of the Texas Constitution by House Bill 2965, as passed by the 75th Texas Legislature and as amended (the “Act”). The Authority began operations in October 1999. The Act empowers the Authority to provide for the conservation, preservation, protection, recharge and prevention of waste of groundwater and for the reduction of groundwater withdrawals.

The Authority may charge a fee, based on the amount of water pumped from the well, to the owner of wells located in the Authority’s boundaries, unless exempted. The fees established by the Board of Directors must be sufficient to: (1) achieve water conservation, prevent waste of water, serve as a disincentive to pumping groundwater and make available alternative water supplies; and (2) enable the Authority to meet operation and maintenance expenses and pay the principal and interest on any debt issued by the Authority.

The accompanying financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America. The following is a summary of the most significant policies:

Reporting Entity

The Authority is a political subdivision of the State of Texas governed by an elected five member board. As required by generally accepted accounting principles, these financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations or functions as part of the Authority’s financial reporting entity. No other entities, organizations or functions have been included in the Authority’s financial reporting entity. Additionally, as the Authority is considered a primary government for financial reporting purposes, its activities are not considered a part of any other governmental or other type of reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations or functions in the Authority’s financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the Authority is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the Authority’s financial reporting entity status is that of a primary government are: that it has a separate governing body; it is legally separate; and it is fiscally independent of other state and local governments. Additional prescribed criteria under generally accepted accounting principles include; considerations pertaining to organizations for which the primary government is financially accountable; and considerations pertaining to other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

Basic Financial Statements

The basic financial statements include the *Statements of Net Assets*, the *Statements of Revenues, Expenses and Changes in Net Assets* and the *Statements of Cash Flows*. These statements focus on the sustainability of the Authority as an entity and the change in aggregate financial position resulting from these activities for the fiscal year.

Note 1- Summary of Significant Accounting Policies (continued)

Measurement Focus and Basis of Accounting

The Authority follows proprietary fund accounting and reporting requirements, which utilize the economic resources measurement focus and the accrual basis of accounting. The Authority follows generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB) and all Financial Accounting Standard Board's (FASB) standards issued prior to November 30, 1989. The Authority has elected not to apply FASB pronouncements issued after that date.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues are charges to customers for pumpage fees. Operating expenses include the cost of services, administrative expenses and depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net assets are classified into the following three components:

- Invested in capital assets, net of related debt – this component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, capital contribution credits or other borrowings.
- Restricted – net assets are reported as restricted when constraints placed on net asset use are either externally imposed by creditors (such as through debt covenants), grantors, contributors or laws or regulations of other governments or imposed through enabling legislation.
- Unrestricted – this component of net assets consists of net assets that do not meet the definition of the previous two categories.

Cash and Cash Equivalents

For the purpose of the *Statement of Cash Flows*, the Authority defines cash and cash equivalents as cash on hand, demand deposits, certificates of deposit and investments in local government investment pools (i.e., TexPool, TexPool Prime and TexSTAR).

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by an allowance for amounts considered uncollectible. At December 31, 2009 an allowance for possible uncollectible accounts was not considered necessary.

Restricted Assets

Proceeds of bonds or other resources set aside for specific purposes are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants or contractual agreements.

Note 1- Summary of Significant Accounting Policies (continued)

Capital Assets

The Authority defines capital assets as assets with an individual cost of \$5,000 or more and an estimated useful life in excess of one year. Capital assets, which include land, right of way acquisition costs, infrastructure and interest in infrastructure assets constructed by the City of Houston, are reported at historical cost. Donated assets are recorded at their estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized. Capital assets are depreciated using the straight-line method over the following estimated useful lives:

<u>Asset</u>	<u>Years</u>
Computer and software	3
Furniture and equipment	5-7
Infrastructure	20-45

Interest costs on assets acquired with tax-exempt borrowings are capitalized, net of interest earned on related interest-bearing investments acquired with proceeds of the related borrowings, from the date of borrowing until the assets are ready for their intended use. During the current fiscal year, the Authority incurred interest costs of \$23,314,020 on construction related tax exempt borrowings and capitalized \$5,487,481 of net interest.

Long Term Obligations

Long term debt and other long term obligations are reported as liabilities on the Authority's *Statement of Net Assets*. Bonds payable are reported net of any applicable discount or premium. Bond issuance costs are reported as a deferred charge (i.e., a non-current asset) and are amortized over the life of the bonds to which they relate using the straight line method, which approximates the effective interest method.

Compensated Employee Absences

Compensated employee absences, which include vacation, compensatory time and sick leave, are accumulated during employment and are accrued when earned. The rate at which an employee earns benefits will vary depending upon their employment status, years employed and position with the Authority. Full-time employees are eligible for vacation time after six months employment and earn between 10 and 25 days vacation per year. At December 31, up to 40 hours of vacation leave is automatically converted to compensatory time. Employees who work at least 32 hours per week earn sick leave at the rate of 3-5 hours per pay period, not to exceed 480 hours. Upon termination, employees are paid for accumulated vacation and compensatory time. The General Manager is also entitled to receive compensation for accrued sick leave.

Note 1- Summary of Significant Accounting Policies (continued)

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 reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

Note 2 – Cash and Investments

Restricted Cash and Investments

Cash and investments were restricted for the following purposes at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Bond reserves	\$ 53,372,312	\$ 58,490,049
Capital improvements	112,345,421	227,731,262
	<u>\$ 165,717,733</u>	<u>\$ 286,221,311</u>

Deposit Custodial Credit Risk

Custodial credit risk as it applies to deposits (i.e. cash and certificates of deposit) 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 Authority’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 Authority’s written investment policy establishes additional requirements for collateralization of deposits. As of December 31, 2009, all of the Authority’s deposits are insured or fully collateralized.

Investments

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

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 2 – Cash and Investments (continued)

As of December 31, 2009, the Authority’s investments and maturities are as follows:

Investment Type	Fair Value	Percentage of Total	Maturities in Years		
			Less Than 1	1-5	6-10
Federal National Mortgage Association	\$ 70,573,477	33.2%	\$ 70,573,477	\$ -	\$ -
Federal Home Loan Mortgage Corporation	52,129,491	24.5%	52,129,491		
Federal Home Loan Bank	22,121,343	10.4%	22,121,343		
Federal Farm Credit Bank	599,102	0.3%	599,102		
U.S. Treasury bills	299,057	0.1%	299,057		
Small Business Administration pools	176,058	0.1%	176,058		
Certificates of deposit	23,288,962	11.0%	23,288,962		
TexPool	3,183,712	1.5%	3,183,712		
TexPool Prime	10,723,829	5.0%	10,723,829		
TexSTAR	29,280,795	13.8%	29,280,795		
	<u>\$ 212,375,826</u>	<u>100.0%</u>	<u>\$ 212,375,826</u>	<u>\$ -</u>	<u>\$ -</u>

The Authority considers the investments in TexPool, TexPool Prime and TexSTAR to have a maturity of less than one year because the weighted average maturities of these pools are 59 days, 42 days and 59 days, respectively. All of the Authority’s investments are AAA rated, with the exception of certificates of deposit, which are not rated. As previously noted, the investment pools and certificates of deposit are reported as cash equivalents on the *Statement of Net Assets*.

As of December 31, 2008, the Authority’s investments were as follows:

	Fair Value	Percentage of Total	Maturities in Years		
			Less Than 1	1-5	6-10
TexPool	\$ 15,746,185	4.8%	\$ 15,746,185	\$ -	\$ -
TexPool Prime	161,595,194	48.9%	161,595,194		
TexSTAR	152,907,465	46.3%	152,907,465		
	<u>\$ 330,248,844</u>	<u>100.0%</u>	<u>\$ 330,248,844</u>	<u>\$ -</u>	<u>\$ -</u>

The Authority considers the investments in TexPool, TexPool Prime and TexSTAR to have a maturity of less than one year because the weighted average maturities of these pools are 55 days, 56 days and 73 days, respectively. All of the Authority’s investments at December 31, 2008 are AAA rated. The Authority’s

Investment income is comprised of the following:

	<u>2009</u>	<u>2008</u>
Interest	\$ 1,149,067	\$ 4,032,377
Realized losses	(192,714)	
Net increase in fair value of investments	1,060,168	
Total	<u>\$ 2,016,521</u>	<u>\$ 4,032,377</u>

Note 2 – Cash and Investments (continued)

Investment Pools

The Authority participates in TexPool, the Texas Local Government Investment Pool. The State Comptroller of Public Accounts exercises oversight responsibility of TexPool, which includes (1) the ability to significantly influence operations, (2) designation of management and (3) accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The Advisory Board members review the investment policy and management fee structure. Although TexPool is not registered with the SEC as an investment company, it operates in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. As permitted by GAAP, TexPool uses amortized cost (which excludes unrealized gains and losses) rather than market value to compute share price. Accordingly, the fair value of the Authority's position in TexPool is the same as the value of TexPool shares.

The Authority also participates in TexSTAR, which also operate as 2a-7 like investment pools. TexSTAR is managed by First Southwest Asset Management and JP Morgan Chase. As with TexPool, the Authority's position in TexSTAR is the same as the value of the Authority's share in TexSTAR.

Investment Risks

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. Custodial credit risk is the risk that the investor will not be able to recover the value of its investments that are in the possession of an outside party if the counterparty fails. The Authority's investment policies do not address these risks beyond the rating and maturity restrictions established by state statutes.

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 3 – Capital Assets

A summary of changes in capital assets during the year ended December 31, 2009, follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Capital assets not being depreciated:				
Land and ROW acquisition	\$ 16,744,457	\$ 2,153,247	\$	\$ 18,897,704
Construction in progress	57,161,235	59,473,287	(26,209,246)	90,425,276
Non-depreciable capital assets	<u>73,905,692</u>	<u>61,626,534</u>	<u>(26,209,246)</u>	<u>109,322,980</u>
Capital assets being depreciated or amortized:				
Interest in treated and untreated water facilities	52,454,277	23,399,523		75,853,800
Interest in transmission facilities	26,064,086			26,064,086
Infrastructure	94,648,148	62,555,369		157,203,517
Furniture, computers & equipment	141,361	12,000		153,361
Subtotal	<u>173,307,872</u>	<u>85,966,892</u>		<u>259,274,764</u>
Less accumulated depreciation and amortization:				
Interest in treated and untreated water facilities	(7,122,998)	(1,949,306)		(9,072,304)
Interest in transmission facilities	(1,742,327)	(580,019)		(2,322,346)
Infrastructure	(4,604,290)	(2,566,203)		(7,170,493)
Furniture, computers & equipment	(136,655)	(3,948)		(140,603)
Subtotal	<u>(13,606,270)</u>	<u>(5,099,476)</u>		<u>(18,705,746)</u>
Depreciable capital assets, net	<u>159,701,602</u>	<u>80,867,416</u>		<u>240,569,018</u>
Total capital assets, net	<u>\$ 233,607,294</u>	<u>\$ 142,493,950</u>	<u>\$ (26,209,246)</u>	<u>\$ 349,891,998</u>

Depreciation and amortization expense for the current year was \$5,099,476.

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 3 – Capital Assets (continued)

The Authority had the following contractual commitments for construction projects at December 31, 2009:

<u>Contract</u>	<u>Contractual Commitment</u>	<u>Construction in Progress</u>	<u>Remaining Commitment</u>
(Project 2-1) Ground storage tanks, yard piping and storm water drainage	\$ 13,149,750	\$ 12,152,086	\$ 997,664
(Project 17-1) 54-inch waterline from Greens Road to West Rankin Road	9,438,769	8,991,297	447,472
(Project 14-A) 30-inch waterline along Cypresswood Dr & Mirror Lake	6,660,830	6,019,791	641,039
(Project 2-2) Spears Road pump station	16,301,970	15,362,883	939,087
(Project 5D) Louetta Regional Water Plant pump station	12,089,980	7,297,854	4,792,126
(Project 6B-3) Water distribution system service connections to Faulky Gully MUD, Grant Rd PUD, HC MUD 18 and NWHCMUD 5 water plants	3,469,634	2,935,951	533,683
(Project 17-3) 60-inch, 20-inch, 16-inch and 12-inch water lines	8,888,553	8,567,635	320,918
(Project 7C3-2) 16-inch waterline along Centerpoint Energy	1,029,608	881,614	147,994
(Project 7C-6) 30-inch waterline along the Kinder Morgan Pipeline easement between Project 7B and NWHC MUD 36	2,585,555	830,865	1,754,691
(Project 7C-5) 16-inch water transmission lines to serve HC MUD 24 and HC WCID 114 along Theiss Gully and Stuebner Airline Drive	2,387,879	1,214,812	1,173,067
(Project 7C4-1) District Connections	2,950,000	2,787,822	162,178
(Project 10B) 42 inch water main - T.C. Jester and 20-inch waterline - Cypresswood	4,588,436	4,263,860	324,576
	<u>\$ 83,540,965</u>	<u>\$ 71,306,469</u>	<u>\$ 12,234,496</u>

The Authority has recorded an additional \$17,335,636 for engineering fees and \$1,783,171 for retainage payable in construction in progress.

Note 4 - Leases

In 2000, the Authority entered into a lease agreement for office space. The lease was amended effective November 1, 2005 and will terminate on January 31, 2011. The Authority may terminate the lease anytime after thirty-six months, by giving twelve months written notice and by paying a lease termination penalty of \$19,500. The Authority has also entered into various leases for office equipment. The Authority paid \$116,528 under these leases during the current period. Future annual commitments for leases are as follows:

<u>Year Ending</u>	<u>Amount</u>
2010	\$ 123,705
2011	20,430
Total	<u>\$ 144,135</u>

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 5 – Long -Term Obligations

The Authority’s long term obligations consist of revenue bonds, capital contributions (see Note 6) and compensated absences (see Note 1).

Compensated Absences

Changes in the Authority’s liability for the last 2 fiscal years are as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	\$ 133,957	\$ 133,564
Increase in liability	140,681	133,957
Decrease in liability	<u>(133,957)</u>	<u>(133,564)</u>
Balance at end of year	<u>\$ 140,681</u>	<u>\$ 133,957</u>

Senior Lien Revenue Bonds

The Authority issues Senior Lien Revenue Bonds (Senior Bonds) primarily to finance the design, acquisition and construction of regional water production, transmission, pumping, storage and distribution systems. The principal and interest on the Authority’s bonds will be repaid from net revenues.

Bonds payable, as reported on the financial statements for years ending 2009 and 2008 consists of the following:

	<u>2009</u>	<u>2008</u>
Bonds payable	\$ 456,675,000	\$ 456,675,000
Unamortized premiums	7,473,926	7,769,921
Unamortized discounts	<u>(3,453,377)</u>	<u>(3,583,043)</u>
Total	<u>\$ 460,695,549</u>	<u>\$ 460,861,878</u>
Due within one year	<u>\$ 4,605,000</u>	<u>\$ -</u>

There were no changes to the Authority’s long term bonded debt during the current fiscal year.

Bonds payable at December 31, 2009 are comprised of the following issues:

Series	Amounts Outstanding	Original Issue Amount	Interest Rates	Maturity Date, Serially, Beginning /Ending	Interest Payment Dates	Callable Date
2003	\$ 124,685,000	\$ 124,685,000	5.00% - 5.25%	December 15, 2010/2033	June 15 / December 15	December 15, 2013
2005	93,875,000	93,875,000	3.50% - 5.25%	December 15, 2010/2035	June 15 / December 15	December 15, 2014
2008	238,115,000	238,115,000	4.00% - 5.50%	December 15, 2013/2038	June 15 / December 15	December 15, 2018
	<u>\$ 456,675,000</u>					

Note 5 – Long -Term Obligations (continued)

The Senior Bonds are secured by a lien on and pledge of the net revenues of the Authority. As additional security, the bond resolutions required the establishment of an Interest and Sinking Fund, a Reserve Fund and a Coverage Fund. A description of each fund follows:

- Interest and Sinking Fund - Used to accumulate the funds required to make the scheduled payments of debt service on the Senior Bonds. Money in the Interest and Sinking Fund shall be used solely for the purpose of paying principal, interest and any bank charges and other costs associated with payments of debt service on the Senior Bonds. Investments restricted for this fund as of December 31, 2009 were \$14,002,202.
- The Reserve Fund –Used (to the extent that amounts on deposit in the Interest and Sinking Fund and the Coverage Fund are insufficient) to secure and provide for the payment of principal and interest on the Senior Bonds as they become payable. As of December 31, 2009, the Reserve Fund requirements were \$32,740,030. The Authority has investments restricted for this fund in the amount of \$28,380,101. The remaining requirement of \$4,359,929 is being funded in accordance with the Authority’s bond resolutions as discussed below. Insurance surety bonds are on hand for the Series 2003 and Series 2005 Bonds to secure performance and satisfy bond covenants.
- The Coverage Fund – Used to accumulate funds equal to 25% of the maximum annual debt service requirements for outstanding debt in any fiscal year. As of December 31, 2009, investments restricted by bond covenants for this fund were \$8,185,008, with an additional \$254,830 in accumulated interest.
- Operation and Maintenance Reserve Fund – Funds from gross revenues of the Authority will be deposited on or before the last business day of the month into this account. Investments restricted for this fund were \$2,805,000 as of December 31, 2009.

The Authority was in compliance with the bond covenants as of December 31, 2009.

Reserve Fund

The purpose of the Reserve Fund is to provide for ready access to funds on short notice in the event that the Authority is ever unable to make debt service payments in a timely manner. Accordingly, the Reserve Fund must contain cash and investments in a required minimum amount (the “Reserve Fund Requirement”) which is equal to the maximum annual debt service payments on the related bonds. In the alternative, the Reserve Fund Requirement may be satisfied with either: (i) a surety bond or insurance policy, if the insurer strength rating of the issuer of the surety bond or insurance policy is rated “AAA” or the equivalent; or (ii) an unconditional irrevocable letter of credit issued by a bank rated “AA” or the equivalent.

During 2008, the rating for the insurer of Series 2003 bonds fell below “A”, while the rating for the Series 2005 insurer fell below “AAA”. As a result of these downgrades, the Reserve Fund Requirement at December 31, 2009 is \$32,740,030, which consists of \$9,079,000 for the Series 2003 Senior Bonds, \$6,587,618 for the Series 2005 Senior Bonds and \$17,073,412 for the 2008 Senior Lien Revenue Bonds.

Note 5 – Long -Term Obligations (continued)

The Master Resolution provides that, in the event the insurer strength rating of the provider of a surety bond satisfying the Reserve Fund Requirements falls below “AAA” (but not below “A”), the Authority must take one of the following steps:

- i. deposit into the Reserve Fund cash sufficient to cause money in the Reserve Fund to accumulate to the Reserve Fund Requirement, such amount to be paid over the ensuing five years in equal installments at least semi-annually, or
- ii. replace the surety bond with another surety bond, insurance policy or letter of credit issued by an adequately rated provider within six months of such downgrade.

The Master Resolution further provides that in the event the insurer strength rating of the provider of a surety bond satisfying the Reserve Fund Requirement falls below “A”, the Authority must take one of the following steps:

- i. deposit into the Reserve Fund cash sufficient to cause the money in the Reserve Fund to accumulate to the Reserve Fund Requirement, such amount to be paid over the ensuing year in equal installments on at least a monthly basis, or
- ii. replace such instrument with a surety bond, insurance policy or letter of credit issued by an adequately rated provider within six months of such occurrence.

The Authority completed an analysis of the alternatives listed above and determined to fund the Reserve Fund Requirements with legally available funds on hand. The Series 2003 Bond Reserve Fund Requirement has been fully funded as of December 31, 2009, \$5,291,166 was funded in the prior year and \$3,760,000 was funded in the current year with transfers from the operating account. The 2003 Reserve Fund balance is \$9,116,064 as of December 31, 2009, which includes interest earned on the funds.

The 2005 Series Bonds are being funded over a period of two years in installments. The first payment was made in July 2008. The Authority funded \$657,570 of the Requirement in 2008. During the current fiscal year, the Authority transferred \$1,315,000 from the operating fund to the 2005 Debt Service Reserve Account. As of December 31, 2009, the deficit for the Series 2005 Bonds is \$4,605,856. The Authority will continue to make installment payments of \$110,000 and will fund the remaining 2005 Series Reserve Fund Requirement by June, 2010. The 2005 Reserve Fund balance is \$1,981,762 as of December 31, 2009, which includes interest earned on the funds.

The Reserve Fund Requirements for the 2008 Series were funded by the Series 2008 Bond proceeds as permitted by the Resolution and Texas Law. Due to interest earned on the investments, this fund has a surplus of \$208,863.

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 5 – Long -Term Obligations (continued)

Debt Service Requirements

As of December 31, 2009, the debt service requirements on the Senior Bonds outstanding are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Totals</u>
2010	\$ 4,605,000	\$ 23,480,350	\$ 28,085,350
2011	4,810,000	23,277,775	28,087,775
2012	5,025,000	23,061,150	28,086,150
2013	9,920,000	22,809,900	32,729,900
2014	10,385,000	22,345,150	32,730,150
2015	10,890,000	21,841,262	32,731,262
2016	11,445,000	21,290,800	32,735,800
2017	12,020,000	20,714,124	32,734,124
2018	12,625,000	20,109,324	32,734,324
2019	13,260,000	19,476,293	32,736,293
2020	13,955,000	18,780,143	32,735,143
2021	14,685,000	18,047,507	32,732,507
2022	15,475,000	17,259,669	32,734,669
2023	16,285,000	16,442,069	32,727,069
2024	17,120,000	15,609,756	32,729,756
2025	17,985,000	14,746,386	32,731,386
2026	18,900,000	13,836,762	32,736,762
2027	19,850,000	12,880,856	32,730,856
2028	20,855,000	11,876,892	32,731,892
2029	21,910,000	10,822,092	32,732,092
2030	23,030,000	9,701,256	32,731,256
2031	24,210,000	8,523,080	32,733,080
2032	25,450,000	7,284,506	32,734,506
2033	26,755,000	5,982,468	32,737,468
2034	19,050,000	4,606,531	23,656,531
2035	20,070,000	3,586,243	23,656,243
2036	14,560,000	2,511,894	17,071,894
2037	15,355,000	1,718,044	17,073,044
2038	16,190,000	881,462	17,071,462
Totals	<u>\$ 456,675,000</u>	<u>\$ 413,503,744</u>	<u>\$ 870,178,744</u>

Principal and interest payments on the Senior Bonds will be provided through the payment of pumpage fees by utility districts and non-exempt well owners.

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 6 – Capital Contributions

In 2003, the Authority entered into contracts with twenty-four Municipal Utility Districts (MUDs) to provide funds to pay capital expenses of the Authority’s system. Each MUD has paid a Capital Contribution based on a percentage of its pro-rata share of the total groundwater production for all water utilities during the calendar year 2002. Capital contributions of \$32,573,177 were made to the Authority in the 2003 fiscal year. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2003 Senior Bonds beginning with the 2003 third quarter pumpage fees. Any amounts remaining plus accrued interest at the end of the capital contribution expiration date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

Future contribution credits including interest, principal and remaining balance, at the effective interest rate of the Senior Bonds for the 2003 capital contributions as of December 31, 2009 are as follows:

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Remaining Balance</u>
2010	\$ 1,647,388	\$ 726,454	\$ 2,373,842	\$ 31,846,723
2011	1,610,648	763,194	2,373,842	31,083,529
2012	1,572,049	801,793	2,373,842	30,281,736
2013	1,531,499	842,343	2,373,842	29,439,393
2014	1,488,897	884,945	2,373,842	28,554,448
2015	1,444,141	929,701	2,373,842	27,624,747
2016	1,397,122	976,720	2,373,842	26,648,027
2017	1,347,724	1,026,118	2,373,842	25,621,909
2018	1,295,828	1,078,014	2,373,842	24,543,895
2019	1,241,307	1,132,535	2,373,842	23,411,360
2020	1,184,030	1,189,812	2,373,842	22,221,548
2021	1,123,855	1,249,987	2,373,842	20,971,561
2022	1,060,637	1,313,205	2,373,842	19,658,356
2023	994,221	1,379,621	2,373,842	18,278,735
2024	924,447	1,449,395	2,373,842	16,829,340
2025	851,144	1,522,698	2,373,842	15,306,642
2026	774,133	1,599,709	2,373,842	13,706,933
2027	693,228	1,680,614	2,373,842	12,026,319
2028	608,231	1,765,611	2,373,842	10,260,708
2029	518,935	1,854,907	2,373,842	8,405,801
2030	425,123	1,948,719	2,373,842	6,457,082
2031	326,567	2,047,275	2,373,842	4,409,807
2032	223,026	2,150,816	2,373,842	2,258,991
2033	114,248	2,258,991	2,373,239	-
	<u>\$ 24,398,428</u>	<u>\$ 32,573,177</u>	<u>\$ 56,971,605</u>	

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 6 – Capital Contributions (continued)

In 2005, the Authority entered into agreements with nineteen MUDs. Capital contributions of \$14,675,978 were made to the Authority in the 2005 fiscal year. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2005 Senior Bonds beginning with the 2005 third quarter pumpage fees. As with the 2003 contribution credits, any amounts remaining plus accrued interest at the end of the capital contribution date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

Future contribution credits including interest, principal and remaining balance, at the effective interest rate of the Senior Bonds for the 2005 capital contributions as of December 31, 2009 are as follows:

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Remaining Balance</u>
2010	\$ 705,724	\$ 295,155	\$ 1,000,879	\$ 14,380,823
2011	691,531	309,348	1,000,879	14,071,475
2012	676,655	324,224	1,000,879	13,747,251
2013	661,064	339,815	1,000,879	13,407,436
2014	644,723	356,156	1,000,879	13,051,280
2015	627,597	373,282	1,000,879	12,677,998
2016	609,647	391,232	1,000,879	12,286,766
2017	590,834	410,045	1,000,879	11,876,721
2018	571,116	429,763	1,000,879	11,446,958
2019	550,450	450,429	1,000,879	10,996,529
2020	528,790	472,089	1,000,879	10,524,440
2021	506,089	494,790	1,000,879	10,029,650
2022	482,296	518,583	1,000,879	9,511,067
2023	457,359	543,520	1,000,879	8,967,547
2024	431,222	569,657	1,000,879	8,397,890
2025	403,829	597,050	1,000,879	7,800,840
2026	375,119	625,760	1,000,879	7,175,080
2027	345,028	655,851	1,000,879	6,519,229
2028	313,490	687,389	1,000,879	5,831,840
2029	280,436	720,443	1,000,879	5,111,397
2030	245,792	755,087	1,000,879	4,356,310
2031	209,482	791,397	1,000,879	3,564,913
2032	171,426	829,453	1,000,879	2,735,460
2033	131,540	869,339	1,000,879	1,866,121
2034	89,736	911,143	1,000,879	954,978
2035	45,902	954,978	1,000,880	-
	<u>\$ 11,346,877</u>	<u>\$ 14,675,978</u>	<u>\$ 26,022,855</u>	

*North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009*

Note 6 – Capital Contributions (continued)

In 2008, the Authority entered into contracts with twenty-three MUDs to provide funds to pay capital expenses of the Authority’s system. Each MUD has paid or will pay, a Capital Contribution based on a percentage of its pro-rata share of the total groundwater production for all water utilities during the calendar year 2009. Capital contributions of \$30,010,202 were made to the Authority in the 2008 fiscal year. The Authority received an additional \$5,886,678 in the current fiscal year for total contributions for 2008 contributions of \$35,896,880. The Authority shall receive an additional \$4,810,313 for 2008 Capital Contributions, based on the contracts with the MUDs, in the near future. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2008 Senior Bonds beginning with the 2009 first quarter pumpage fees. Any amounts remaining plus accrued interest at the end of the capital contribution expiration date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

Future contribution credits including interest, principal and remaining balance, at the effective interest rate of the Senior Bonds for the 2008 capital contributions as of December 31, 2009 are as follows:

Year	Interest	Principal	Total	Remaining Balance
2010	\$ 1,929,637	\$	\$ 1,929,637	\$ 35,896,880
2011	1,929,637		1,929,637	35,896,880
2012	1,929,637		1,929,637	35,896,880
2013	1,929,637		1,929,637	35,896,880
2014	1,929,637	714,027	2,643,664	35,182,853
2015	1,891,254	752,410	2,643,664	34,430,443
2016	1,850,808	792,856	2,643,664	33,637,587
2017	1,808,188	835,476	2,643,664	32,802,111
2018	1,763,277	880,387	2,643,664	31,921,724
2019	1,715,952	927,712	2,643,664	30,994,012
2020	1,666,083	977,581	2,643,664	30,016,431
2021	1,613,533	1,030,131	2,643,664	28,986,300
2022	1,558,159	1,085,505	2,643,664	27,900,795
2023	1,499,807	1,143,857	2,643,664	26,756,938
2024	1,438,319	1,205,345	2,643,664	25,551,593
2025	1,373,526	1,270,138	2,643,664	24,281,455
2026	1,305,250	1,338,414	2,643,664	22,943,041
2027	1,233,303	1,410,361	2,643,664	21,532,680
2028	1,157,489	1,486,175	2,643,664	20,046,505
2029	1,077,600	1,566,064	2,643,664	18,480,441
2030	993,416	1,650,248	2,643,664	16,830,193
2031	904,707	1,738,957	2,643,664	15,091,236
2032	811,229	1,832,435	2,643,664	13,258,801
2033	712,727	1,930,937	2,643,664	11,327,864
2034	608,929	2,034,735	2,643,664	9,293,129
2035	499,552	2,144,112	2,643,664	7,149,017
2036	384,295	2,259,369	2,643,664	4,889,648
2037	262,843	2,380,821	2,643,664	2,508,827
2038	134,862	2,508,827	2,643,689	-
	<u>\$ 37,913,293</u>	<u>\$ 35,896,880</u>	<u>\$ 73,810,173</u>	

North Harris County Regional Water Authority
Notes to Basic Financial Statements
December 31, 2009

Note 6 – Capital Contributions (continued)

Future contribution credits including interest, principal and remaining balance, at the effective interest rate of the Senior Bonds for all capital contributions as of December 31, 2009 are as follows:

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>	<u>Remaining Balance</u>
2010	\$ 4,282,749	\$ 1,021,609	\$ 5,304,358	\$ 82,124,426
2011	4,231,816	1,072,542	5,304,358	81,051,884
2012	4,178,341	1,126,017	5,304,358	79,925,867
2013	4,122,200	1,182,158	5,304,358	78,743,709
2014	4,063,257	1,955,128	6,018,385	76,788,581
2015	3,962,992	2,055,393	6,018,385	74,733,188
2016	3,857,577	2,160,808	6,018,385	72,572,380
2017	3,746,746	2,271,639	6,018,385	70,300,741
2018	3,630,221	2,388,164	6,018,385	67,912,577
2019	3,507,709	2,510,676	6,018,385	65,401,901
2020	3,378,903	2,639,482	6,018,385	62,762,419
2021	3,243,477	2,774,908	6,018,385	59,987,511
2022	3,101,092	2,917,293	6,018,385	57,070,218
2023	2,951,387	3,066,998	6,018,385	54,003,220
2024	2,793,988	3,224,397	6,018,385	50,778,823
2025	2,628,499	3,389,886	6,018,385	47,388,937
2026	2,454,502	3,563,883	6,018,385	43,825,054
2027	2,271,559	3,746,826	6,018,385	40,078,228
2028	2,079,210	3,939,175	6,018,385	36,139,053
2029	1,876,971	4,141,414	6,018,385	31,997,639
2030	1,664,331	4,354,054	6,018,385	27,643,585
2031	1,440,756	4,577,629	6,018,385	23,065,956
2032	1,205,681	4,812,704	6,018,385	18,253,252
2033	958,515	5,059,267	6,017,782	13,193,985
2034	698,665	2,945,878	3,644,543	10,248,107
2035	545,454	3,099,090	3,644,544	7,149,017
2036	384,295	2,259,369	2,643,664	4,889,648
2037	262,843	2,380,821	2,643,664	2,508,827
2038	134,862	2,508,827	2,643,689	-
	<u>\$ 73,658,598</u>	<u>\$ 83,146,035</u>	<u>\$ 156,804,633</u>	

Note 7 – Unrestricted Net Assets

Included in the Authority's unrestricted net assets of \$67,138,348, is \$59,798,317 which the Authority has designated as additional bond reserves and has been deposited in the Improvement Fund.

Note 8 – Risk Management

The Authority is exposed to various risks related to torts: theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The Authority's risk management program encompasses various means of protecting the Authority against loss by obtaining property, casualty and liability coverage through commercial insurance carriers. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

Note 9 – Deferred Compensation Plans

The Authority offers its employees a deferred compensation plan created in accordance with Internal Revenue Code, Section 457. The plan is available and permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The plan is administered by the International City Management Association - Retirement Corporation (ICMA-RC).

Note 10 – Pension Plan

The Authority has established the North Harris County Regional Water Authority Qualified Pension Plan 401(a) (the "Plan"). The Plan covers all employees. Under the terms of the Plan, active participants become 100% vested on the fifth anniversary of employment. Participants are eligible for payment of benefits upon reaching age 70½, becoming disabled or separating from service for any other reason. Benefits are distributed in accordance with the instructions of the participants. The Board of Directors appointed ICMA-RC to serve as Plan administrator and trustee. The Plan provides for a minimum Authority contribution of 7% of total current covered payroll. At December 31, 2009, all of the Authority's employees were members of the Plan. Non-vested contributions are immaterial to total contributions at December 31, 2008. Vested contributions are solely the possession of participating employees. Total current payroll was \$1,034,524 for the year ended December 31, 2009, of which \$1,007,524 was covered under the Plan. Employer contributions to the Plan for the year ended December 31, 2009 were \$147,918.

In 2003, the Authority established an additional 401(a) plan for management employees only. It is identical to the above Plan with the following exceptions: 1) management employees are fully vested on the second anniversary of employment and 2) the Plan provides for a minimum Authority contribution of 25% for the current year annual covered payroll of the General Manager. The total payroll and employer contributions for this plan are included in the totals above.

Note 11 – Water Supply Contracts

In December 2002, the Authority entered into a forty year contract with the City of Houston (Houston) for the purchase of capacity in certain untreated water facilities and treated water facilities, including transmission facilities, of Houston. Under the terms of the contract, Houston will provide surface water to the Authority at a point of delivery to be located near Highway 59 and Beltway 8.

The contract stipulates that the Authority will purchase capacity, in phases, in Houston's surface water system. Houston will be responsible for the design, construction, ownership, maintenance and operation of both treated and untreated water facilities prior to a mutually agreeable delivery point(s). The Authority will be responsible for the design, construction, ownership, maintenance and operation of all facilities located beyond the point of delivery.

Note 11 – Water Supply Contracts (continued)

During 2003, the Authority made its first payment of \$51,492,844 to Houston for the purchase of capacity in Houston's treated water facilities and transmission facilities constructed prior to the effective date of the contract. In the current fiscal year, the Authority made additional payments for the total amount of \$21,799,523 for the Existing Untreated Water Facilities Initial Untreated Water Demand Allocation of 31 million gallons per day ("MGD").

The Authority will pay Houston, on a monthly basis, its pro-rata share of operating and maintenance costs of the treated and untreated water facilities and transmission lines based on an annual operating budget once it begins receiving water. Such monthly payments will include an amount adequate to establish an operating reserve. The contract also provides the Authority with the option to purchase additional capacity in the future.

In March 2003, the Authority entered into an Interim Treated Water Supply Contract with Houston. Subject to the terms of this contract, the Authority entered into an agreement with Emerald Forest Utility District (the "District") for water supply. In the 2003 fiscal year, the Authority reimbursed the District \$36,694 for the cost of constructing a water line to Houston's line. During the current year, the Authority paid Houston \$71,767 on behalf of the District for purchased water. The Authority also paid Houston \$24,751 for purchased surface water.

In January 2009, the Authority and Houston executed the First Supplement (the "Supplement") to the Water Supply Contract to increase the supply of untreated surface water available to the Authority, Houston and the other entities through the construction of the Luce Bayou Interbasin Transfer Project ("Luce Bayou"). When completed, Luce Bayou will convey approximately 400 MGD of untreated surface water from the Trinity River to Lake Houston. The Supplement addresses the allocation of capacity in Luce Bayou and how the costs of the project will be shared by the Authority, the other entities and Houston. The Supplement and Water Supply Contract remain in effect until 2080.

The Coastal Water Authority (CWA) has been designated as the project manager and, working with Houston, is responsible for all decisions and actions relating to the design, development, procurement and construction of all aspects of Luce Bayou. Houston will issue (or cause CWA to issue) bonds, notes or other obligations to pay for all of the costs of the project, except for the right-of-way costs and CWA interest amount (\$360,836 as calculated in the Supplement). In addition to the other terms of the Supplement, neither party shall have any obligation to pay any funds for the project unless and until the City or CWA have obtained \$28,000,000 in funding from the Texas Water Development Board's Water Infrastructure Fund that provides for: (i) the accrual of zero interest on such funds for up to 10 years or until the project is completed, whichever occurs first; and (ii) no interest or principal payments on such funds during the 10 year period.

Houston agrees to cause the construction of the project so that it is substantially complete by June 30, 2019. The project will be completed in two stages as follows: (1) Phase I will be the permitting, engineering, surveying, right-of-way and site acquisition, which is currently estimated at a cost of \$43,000,000 and (2) Phase II of the project will be the construction and related costs, which is currently estimated at a cost of \$214,000,000.

Note 11 – Water Supply Contracts (continued)

Under the terms of the contract, the Authority will make the following payments to Houston:

- Lump Sum Payments for Project Right of Way Costs and Payment of CWA Interest Costs;
- Payments for Existing Untreated Water Supply Facilities; and
- Payments for Phases 1 and 2 Annual New Untreated Water Facilities.

Lump Sum Payments. Payment of the Authority’s pro-rata share of the CWA interest costs is \$57,734 which was paid January 27, 2009. Currently, Houston estimates that the right-of-way costs will be \$15,000,000. The Authority will pay, or has paid Houston a lump sum payment for these costs in two payments as follows: (1) \$1,600,000 which was paid June 15, 2009 and (2) \$800,000 will be paid no later than June 15, 2010.

Houston and the Authority agreed to “true-up” the payments made by the Authority for the right-of-way costs such that if the Authority has underpaid, taking into account interest accrued, it will pay Houston for the shortfall within 60 days of receiving the final accounting and Houston agrees to refund the Authority any overpayment within 60 days of receiving the final accounting.

Payments for Existing Untreated Water Facilities. The Authority seeks to increase its Untreated Water Facilities Demand from 31 MGD to 159 MGD, which is currently estimated to be the Authority’s surface water demand in the year 2040. Under the terms of the Supplement, the Authority is required to make four payments to Houston for Existing Untreated Water Facilities. Each payment is based on a formula defined in the Supplement based on the Authority’s water demand needs in 2025, 2030, 2035 and 2040.

The first payment is due within 60 days of receiving notification from Houston of the completion of Luce Bayou; the second payment is due the earlier of 60 days after sending notice to Houston of the Authority’s water demand needs for 2030 or June 30, 2025; the third payment is due the earlier of 60 days after sending notice to Houston of the Authority’s water demand needs for 2035 or June 30, 2030; and the fourth payment is due the earlier of 60 days after sending notice to Houston of the Authority’s water demand needs for 2040 or June 30, 2035.

Payment for Phases 1 and 2 Annual New Untreated Water Facilities. Payments made to Houston for Phase 1 and 2 Annual New Untreated Water Facilities are to be used only for the purpose of making debt service payments on obligations issued by either Houston or CWA for the construction of Phase 1 and Phase 2 of Luce Bayou. The formulas used to calculate payments are defined in the contract and take into consideration the Authority’s 159 MGD untreated water reservation, the total amount of untreated water sold by Houston to all customers and Houston’s annual debt service requirement.

Note 12 – Agreement for Joint Financing of Facilities

In 2004, the Authority entered into an Agreement for Joint Financing, Design, Construction, Operation and Maintenance of Surface Water Transmission Facilities (Joint Financing Agreement) with Harris County Municipal Utility District No. 33 (No. 33) for the Central Harris County Water Users Consortium, now Central Harris County Regional Water Authority (the “Central Authority”), a consortium of conservation and reclamation Districts established and operating pursuant to the Central Harris County Water Users Consortium Agreement, dated December 13, 2002. Under the terms of the Joint Financing Agreement, the Authority will construct a sixty-inch water transmission line that is currently planned to commence at the point of delivery, as defined in the Authority’s Water Supply Contract with Houston (see Note 11) to enable the Authority and the Central Authority to receive surface water from the Northeast Water Purification Plant. The joint use facilities shall be completed no later than December 31, 2009.

The Central Authority requires a means to receive surface water from Houston for delivery to the Member Districts and desires to participate in the financing, design, construction, operation and maintenance of the proposed water transmission line. The Authority will hold title to the joint use facilities and the Central Authority will pay a pro-rata share of the costs of right-of-way acquisition, design and construction costs for the joint use facilities. The Central Authority will escrow funds with the Authority for each phase of the construction and design. When each phase is complete, a summary of costs will be compiled and any excess or deficiency will be settled at that time. The Central Authority will also be responsible for its pro-rata share of operation and maintenance costs of the facilities and will be required to establish an operation and maintenance cost reserve with the Authority, based on operation and maintenance budgets to be prepared annually. The estimated cost of the transmission line was \$63,681,140, with the Authority’s share being 90.38% and the Central Authority share being 9.62% of such costs.

In October 2007, the Authority entered into an Interlocal Agreement with Central Authority. Under the terms of the Interlocal Agreement, the Authority will acquire properties, rights-of-way, easements and other property interests for the construction, installation and operation and maintenance of the facilities for the transportation, distribution and delivery of water to and within the Authority’s boundaries. The Central Authority will be responsible for its pro-rata share of the total costs incurred in acquiring the easements and related costs.

The Authority will pay for all front-end expenses associated with acquisition of the easements. Once acquisition has been completed, the Authority will provide a detailed invoice to the Central Authority.

In February 2008, the Authority entered into a Letter of Understanding (the “LOU”) with the Central Authority. It was agreed that it was in the best interest of both parties to construct a portion of the proposed Central Authority facilities in conjunction with the Authority’s facilities. Both parties agreed to enter into the LOU, which will serve as an amendment to the Joint Financing Agreement. The Central Authority will be responsible for the design of the Central Authority facilities and will be responsible for all costs associated with incorporating the plans and specifications into the Authority bid packages and its pro-rate share of the bid advertisement cost. The Central Authority will be responsible for the construction cost and the cost of construction administration, project observation, materials testing, reasonable Authority staff costs and any other related costs for the Central Authority Facilities. All costs other than the construction costs will collectively be called construction support costs, which are estimated to be 13% of the construction costs.

Note 12 – Agreement for Joint Financing of Facilities (continued)

Prior to the award of the construction contract by the Authority's Board of Directors, the Central Authority will escrow an amount equal to the construction costs. Within 120 days of the award of the construction contract, the Central Authority will escrow an amount equal to the Central Authority's pro-rata share of the construction support costs. In the prior year, the Central Authority escrowed \$605,168 with the Authority. In the current fiscal year, the Authority received an additional \$78,762 from the Central Authority for additional construction support costs. However, no amounts held by the Authority on behalf of the Central Authority have been used. All funds escrowed with the Authority by the Central Authority were deposited in an interest bearing account and all interest earned on these funds shall belong to the Central Authority.

Upon completion and acceptance of the construction contract, the Authority will conduct a true-up of Central Authority costs for the project and if the amount escrowed exceeds the Central Authority costs for the project, the Authority will refund the excess amount paid by the Central Authority, including any interest earnings. If the amount escrowed is less than the Central Authority costs, the Central Authority will reimburse the Authority for the shortage.

The project was completed in the current fiscal year and costs have been incurred by the Authority related to this agreement. The Authority will hold all amounts paid by the Central Authority until a reconciliation is performed on the final contract amount. At December 31, 2009, the Authority held \$615,767 in escrow on behalf of the Central Authority and has recorded a liability in the amount of \$683,840 for this project.

Upon acceptance of the Central Authority facilities and completion of the true-up process, the Central Authority will assume ownership of the facilities.

Note 13 – Other Interlocal Agreements

Greens Road Water Line

The Authority entered into an Interlocal agreement with the City of Houston (Houston), effective March 11, 2005, for the term of forty years, for the design and construction of the Greens Road water line that will provide the water transmission capacity necessary to serve the needs of Houston and the Authority. Houston has provided estimates to the Authority for real estate costs, engineering costs and contingencies for the project as well as the manner of calculation of such costs and the parties pro rata share of such costs. In the 2005 fiscal year, the Authority paid Houston its pro rata share of estimated construction costs and contingencies in the amount of \$29,187,152. Subsequently, Houston performed a final accounting on the project which resulted in a refund to the Authority in the amount of \$3,123,067, which was received by the Authority during the prior fiscal year. Houston shall hold legal title to the Greens Road Project, however, Houston and the Authority shall each have an undivided equitable interest in, and use and benefit of capacity in the Greens Road water line, in accordance with their pro rata shares of capacity. The estimated capacity of the water line is 76.8 MGD, of which the Authority requires capacity of 44 MGD at the point of delivery in order to have adequate supply of treated surface water for distribution to the Authority's customers to comply with the Harris-Galveston Coastal Subsidence District's 1999 Regulatory Plan, as amended. Houston shall maintain and operate the Greens Road water line. The Authority will be billed for operation and maintenance costs based on their pro rata share of capacity and based on the budget approved by Houston and the Authority.

Note 13 – Other Interlocal Agreements (continued)

Louetta Regional Water Plant

On February 16, 2005, the Authority entered into an Interlocal agreement with Charterwood Municipal Utility District (Charterwood) and V&W Partners, Ltd. (V&W), for the term of forty years. The purpose of this agreement is to enable the Authority to construct a regional water plant in the area of Charterwood to be known as the Louetta Regional Water Plant (the “Louetta Plant”); to enable Charterwood to obtain a supply of water for domestic use to supplement the water supply of Charterwood; and to satisfy the needs of V&W for water service from Charterwood for 98 acres for commercial and residential development, which has been annexed into Charterwood. Under the terms of the agreement, the Authority will purchase a 30 foot wide water line easement from V&W to be used for the placement of two large diameter water lines from the plant site. Upon execution of the agreement, the Authority drilled a test hole for a well on the plant site to determine the feasibility and viability of the proposed wells. The drilling of the test hole was completed in the 2005 fiscal year at the cost of \$260,210, which includes construction costs and engineering. Under the terms of the agreement, the Authority proceeded with the construction of the production wells. Upon determination that there is at least one feasible production well, the Authority proceeded with the design and construction of a water line from the plant site to Charterwood’s Water Plant No. 2. The water line is used by the Authority to convey water from the Authority’s production wells to Charterwood’s Water Plant No. 2 in order for Charterwood to provide a supply of water to its customers. Upon completion of the two water lines, the Authority will own, operate and maintain the lines. Charterwood shall proceed with the construction of additional facilities, including pumps, chlorination equipment, storage tanks and other related equipment that are necessary to treat and distribute the water delivered to Charterwood’s Water Plant No. 2 by the Authority. The Authority shall pay Charterwood its pro rata share of the capital costs of the additional facilities. In the 2005 fiscal year, the Authority paid \$961,433 for its estimated share of the cost of the additional facilities.

The facilities were completed in 2007, a final accounting of construction costs has been made and is in review and the Authority anticipates that they will receive a small refund from Charterwood. In addition, the Authority shall pay Charterwood its pro rata share of the direct costs to repair and maintain the additional facilities. The Authority agrees to deliver water to Charterwood’s Water Plant No. 2, at the point of delivery, in an amount mutually agreed upon by Charterwood and the Authority. Charterwood agrees to purchase water from the Authority to provide a supply of water to its customers. All water delivered by the Authority to and used by Charterwood will be billed to Charterwood and, in turn, water delivered to the Authority by Charterwood will be billed to the Authority. In addition, Charterwood will be able to receive a non-depreciated asset credit for Charterwood’s existing water supply facilities based on the date each facility was constructed, not to exceed \$0.80 per 1,000 gallons of water purchased from the Authority.

Note 13 – Other Interlocal Agreements (continued)

Prestonwood Forest Utility District

In June 2008, the Authority entered into an Interlocal Cost Sharing Agreement with Prestonwood Forest Utility District (Prestonwood). As part of the Authority's GRP, the Authority intends to construct and install a water line, along with related appurtenances, to serve Prestonwood. The Authority will be responsible for the acquisition of necessary easements, design, construction, ownership, maintenance and operation of the project. The term of the agreement is for ten years, unless terminated by mutual agreement of the parties.

The Authority awarded the contract on June 2, 2008 in the amount of \$961,831. Within 30 days from the award of the contract, Prestonwood paid the Authority \$224,177, which consists of the initial difference in two alternatives to complete the project. Prestonwood expressed its preference for alternative 1, with an estimated cost of \$1,558,200 and declined alternative 2, with an estimated cost of \$1,321,600 less the agreed upon value of \$12,423 for two water line easements granted to the Authority by Prestonwood.

A preliminary accounting of construction costs has been made by the Authority and, as a result, the Authority has recorded a liability of \$224,177. According to the agreement, if the final cost is more than the initial cost such that the revised difference is greater than the initial difference, both parties will equally share in the payment of the additional cost difference. If the final cost is less than the initial cost, the Authority will refund Prestonwood 100% of the amount by which the initial difference exceeds the revised difference.

Note 14 – Buy / Sell Agreements

In fiscal years 2005 and 2006, the Authority entered into Buy/Sell agreements for implementation of the Groundwater Transfer Program (GTP) with eighteen utility Districts for the purpose of encouraging the maximum utilization of existing water production facilities to provide water to Districts that are currently in need of water from Districts with a surplus of water. The first priority of the GTP is to supply water to Districts with water quality issues such as arsenic, secondly to Districts needing additional water for growth and finally to Districts needing additional water for peaking purposes. The primary purpose of the GTP is to limit construction of new water wells and related water production facilities that will have limited use after the conversion to surface water in 2010. During a delivery period, a seller shall sell, and the District may purchase a volume of water equal to an amount determined by the Authority to be required from a seller to meet demand and create a minimum flow within the Authority's system. The Authority shall sell, and a buyer shall purchase, a volume of water equal to at least the minimum water demand allocation, if any, and not to exceed the maximum water demand allocation by up to ten percent. A buyer shall pay the Authority for water it receives from the Authority for the purchase price of \$1.70 per 1,000 gallons less applicable depreciation credit times the volume of water delivered by the Authority to the buyer. The depreciation credit will be limited to a maximum of \$0.80 per 1,000 gallons of water purchased. The Authority will pay the seller the sale price of \$0.91 per 1,000 gallons plus an amount equal to the pumpage fee times the volume of water delivered to the Authority by a seller.

Note 15 – Water Well Agreement

On March 28, 2006, the Authority entered into a Water Well Agreement (the “Agreement”) with V&W Partners, Ltd. (V&W), for itself and on behalf of the to be created Harris County Municipal Utility Authority No. 468 (MUD). Under the terms of the agreement, the Authority agreed to acquire a water well from V&W for a price of \$567,306. The Authority also purchased easements from V&W which were used for the placement of two water lines which were purchased by the Authority. The Authority is delivering water, in the amount stated in the agreement, from the water well to the MUD water plant in order to serve customers of the MUD. In addition to the amounts specified in the agreement, the MUD will be entitled to obtain up to 100,000 GPD to provide water supply service to the Hewlett Packard Data Center (HP Data Center).

The MUD has interconnect agreements with Charterwood Municipal Utility District and Harris County Municipal Utility District No. 286 and will be required to provide water to these Districts in emergency situations. The Authority can also utilize the water well to supplement its water supply facilities located north of Louetta Road and may utilize the water to serve customers of the Authority.

Any amount pumped by the Authority and delivered to the MUD will be treated by the MUD and delivered to the Authority’s point of measurement is subject to treatment charges as described in the agreement. The requirements for delivery and treatment of water will apply until such time as the Authority delivers surface water to the MUD in accordance with the Authority’s GRP. Upon delivery of surface water to the MUD, any water pumped from the water well will be sent to the Authority’s water plant north of Louetta Road and the Authority will not be authorized to transmit water directly to the MUD water plant. The MUD agrees to treat water delivered from the Authority’s water well to the MUD water plant and the Authority agrees to pay the MUD for the treatment of the water based upon the MUD’s then current cost to treat water. The initial charge for the treatment of water will be \$0.84 per 1,000 gallons of water delivered to the Authority’s point of measurement and will be adjusted on an annual basis beginning October 1, 2007. The MUD will bill the Authority on a monthly basis for the treated water delivered through the Authority point of measurement. In turn, the Authority will bill the MUD on a monthly basis for the water delivered to the MUD in the amount of \$1.40 per 1,000 gallons of water, which will be increased from time to time as stipulated in the agreement. The MUD will not be required to pay a pumpage fee for such water. At such time the MUD takes surface water from the Authority, the MUD will only be required to pay the amount established by the Authority for the purchase of surface water.

The term of this agreement is forty years with options to renew for successive five year periods, unless terminated by mutual agreement of the parties. As of December 31, 2009, the Authority had paid \$1,211,944 to V&W partners for the well and line improvements, water line easement and water well acquisition in accordance with the Agreement.

Supplementary Information

*North Harris County Regional Water Authority
Schedule of Expenses
Last Five Fiscal Years*

	2009	2008	2007	2006	2005
Personnel					
Employee salaries	\$ 1,034,524	\$ 974,803	\$ 930,979	\$ 900,140	\$ 736,679
Employee retirement	90,243	86,553	85,975	88,884	75,649
Group insurance	73,953	65,626	54,352	51,900	50,802
Medicare/ Social security	66,843	64,132	62,312	59,840	51,028
Workers' compensation insurance	(5,040)			4,033	5,462
Unemployment compensation	360	792	360	2,160	189
	<u>1,260,883</u>	<u>1,191,906</u>	<u>1,133,978</u>	<u>1,106,957</u>	<u>919,809</u>
Professional fees					
Legal	169,702	109,006	120,866	132,978	221,475
Engineering	1,177,452	1,260,849	1,214,640	1,256,984	1,140,686
Financial services	17,820	5,716	6,278	11,205	8,809
Legislative consultant	130,000	130,000	130,000	130,000	130,000
Investment management services	76,865				
Redistricting/mapping	3,500	4,000		4,400	
Audit	26,000	28,000	22,500	21,000	17,500
	<u>1,601,339</u>	<u>1,537,571</u>	<u>1,494,284</u>	<u>1,556,567</u>	<u>1,518,470</u>
Purchased Services					
Bulk water purchases	96,518	64,386	52,101	57,569	50,784
Water purchase - GTP	2,773,732	1,419,299	908,565	668,056	
	<u>2,870,250</u>	<u>1,483,685</u>	<u>960,666</u>	<u>725,625</u>	<u>50,784</u>
Contracted services					
Operations and maintenance	441,463	494,042	523,574	206,747	
Temporary services	11,261	6,757	11,139	6,388	8,933
	<u>452,724</u>	<u>500,799</u>	<u>534,713</u>	<u>213,135</u>	<u>8,933</u>
Occupancy and office					
Office lease	101,987	94,777	87,306	87,628	85,547
Safe deposit box	75	63	63	60	60
Bank charges		33			
Printing and office	130,521	187,361	101,477	63,721	110,138
Postage and delivery	59,392	54,770	27,988	25,712	31,793
Telephone	18,406	16,496	14,969	17,454	15,205
Utilities	227,446	98,777	107,206	64,883	3,107
Equipment leases	14,540	14,985	13,664	13,241	7,476
Meeting sites	3,044	2,159	3,065	2,826	2,562
Internet service	9,443	11,634	15,667		3,468
Communication services	73,664	70,927	67,566	63,017	62,185
Web page			100	1,050	
	<u>638,518</u>	<u>551,982</u>	<u>439,071</u>	<u>339,592</u>	<u>321,541</u>

North Harris County Regional Water Authority
Schedule of Expenses
Last Five Fiscal Years

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Other					
Director fees	\$ 27,000	\$ 25,500	\$ 25,050	\$ 24,900	\$ 26,550
Election expense		2,606		4,900	
Technology transfer projects	38,735	42,307	43,488	47,438	42,363
Insurance	18,347	19,254	19,659	10,717	12,678
Travel and per diem	40,338	40,923	40,010	38,305	31,241
Membership/Subscription fees	6,829	5,463	5,932	5,219	5,423
Computer services	13,348	8,428	10,308	11,058	11,398
Computer software and equipment	16,819	14,304	14,743	27,155	9,701
Maintenance and repairs	14,608	5,951	6,472	5,379	5,445
Office furniture	6,694	822		1,331	10,610
Public education					23,279
Water conservation	52,481	55,112	24,004	63,087	50,941
Mileage reimbursement	7,142	7,491	6,439	5,962	4,220
Permit fees	12,310	15,130	12,832	7,742	7,559
Seminars/training	9,033	15,410	10,055	8,895	5,435
Security	746	696	754	676	3,281
Miscellaneous	168		50,743	153	478
	<u>264,598</u>	<u>259,397</u>	<u>270,489</u>	<u>262,917</u>	<u>250,602</u>
Expenses Before Depreciation and Amortization	<u>7,088,312</u>	<u>5,525,340</u>	<u>4,833,201</u>	<u>4,204,793</u>	<u>3,070,139</u>
Depreciation and Amortization	<u>5,266,852</u>	<u>3,981,318</u>	<u>3,669,081</u>	<u>2,937,335</u>	<u>1,481,005</u>
Total Expenses	<u><u>\$ 12,355,164</u></u>	<u><u>\$ 9,506,658</u></u>	<u><u>\$ 8,502,282</u></u>	<u><u>\$ 7,142,128</u></u>	<u><u>\$ 4,551,144</u></u>

*North Harris County Regional Water Authority
Schedule of Principal Water Users
December 31, 2009*

Name	Pumpage (gallons)	Pumpage Fees Paid	Share (%)
Harris Co. MUD 358	884,636,000	\$ 1,326,954	2.8129%
Harris Co. FWSD 61	822,700,000	1,234,050	2.6159%
Tomball, City of	787,147,000	1,180,721	2.5029%
Bridgestone MUD	685,972,913	1,028,959	2.1812%
NW Harris Co. MUD 5	666,558,900	999,838	2.1196%
Harris Co. WCID 109	579,586,000	869,379	1.8429%
Harris Co. MUD 365	578,707,000	868,061	1.8401%
AquaTexas, Inc.	549,332,100	823,998	1.7467%
Cy-Champ PUD	506,608,040	482,106	1.6109%
Cypress Forest PUD	495,498,000	743,247	1.5755%
Subtotal	6,556,745,953	9,557,313	20.8485%
All other retail utilities	23,868,650,760	31,019,612	75.8951%
All private well owners	1,024,114,020	1,536,171	3.2564%
Total	31,449,510,733	\$ 42,113,096	100.0000%

*North Harris County Regional Water Authority
Miscellaneous Information
December 31, 2009*

Rates and Charges

<u>Effective Date</u>	<u>Pumpage Fee (Rate Per 1,000 Gallons of Water Pumped)</u>
January 1, 2000	\$ 0.12
April 1, 2000	0.25
October 1, 2003	0.34
April 1, 2005	0.59
October 1, 2006	0.84
October 1, 2007	0.99
October 1, 2008	0.99
January 1, 2009	1.50
January 1, 2010	Groundwater 1.75 Surface Water 2.20

Billing and Collection Experience

<u>Calendar Year Ending</u>	<u>Pumpage Reported to Subsidence District (gallons)</u>	<u>Pumpage Reported to Authority (gallons)</u>	<u>Percentage</u>
2002	23,385,003,226	23,304,243,101	99.65%
2003	23,922,957,131	23,919,899,118	99.99%
2004	23,055,346,850	23,002,955,882	99.77%
2005	28,356,373,609	28,351,195,157	99.98%
2006	26,834,935,391	26,822,777,163	99.95%
2007	24,218,161,044	24,199,057,244	99.92%
2008	28,302,980,773	28,274,930,225	99.90%
2009	31,526,248,907	31,449,510,733	99.76%