AMENDMENT TO

OFFICIAL STATEMENT DATED AS OF MARCH 25, 2009

$476,050,000
CITY OF HOUSTON, TEXAS
Combined Utility System
First Lien Revenue and Refunding Bonds,
Series 2009A

CUSIP Prefix: 442435

This Amendment to the Official Statement dated March 25, 2009 is made for the purpose of correcting the description of the underlying ratings to the System, as reflected in the heading "RATINGS" on page 54. All other descriptions and disclosures made in the Official Statement remain as originally described therein. Undefined capitalized terms used herein have the meaning ascribed to them in the Official Statement.

****

Corrected description of underlying ratings to the System:

Fitch, Moody's and Standard & Poor's have assigned underlying ratings of "A+", "A1", and "AA" to the System.

****

Amendment Dated Date: April 8, 2009

PIPER JAFFRAY & CO.

Banc of America Securities LLC **Loop Capital Markets LLC** **Morgan Stanley & Co. Incorporated**

Fidelity Capital Markets **Ramirez & Co., Inc.** **RBC Capital Markets** **Siebert Brandford Shank & Co. LLC** **Southwest Securities**

OFFICIAL STATEMENT DATED AS OF MARCH 25, 2009

NEW ISSUE — BOOK-ENTRY ONLY **RATINGS: See "RATINGS" herein**

The delivery of the Series 2009A Bonds (defined below) is subject to an opinion of Co-Bond Counsel to the effect that, assuming continuing compliance by the City after the date of such opinion with certain covenants described herein, interest on the Series 2009A Bonds is excludable from gross income for federal income tax purposes under existing law and is not includable in the computation of alternative minimum taxable income of individuals or corporations. See "TAX EXEMPTION" herein for a discussion of the opinion of Co-Bond Counsel.

$476,050,000
CITY OF HOUSTON, TEXAS
Combined Utility System
First Lien Revenue and Refunding Bonds, Series 2009A

Interest Accrual Date: Date of Delivery **CUSIP Prefix:** 442435 **Due:** November 15, see inside cover page

The Series 2009A Bonds described above (the "Bonds" or the "Series 2009A Bonds"), are special obligations of the City of Houston, Texas (the "City"), payable as to principal, premium, if any, and interest solely from and secured by a lien on and pledge of Net Revenues (as defined herein), as collected and received, to be derived from operation of the City's combined utility system (the "CUS", "System" or the "Combined Utility System"). The Combined Utility System currently consists of the City's water and sewer system (the "Water and Sewer System"), and may include such other utility systems that the City elects to combine with the Combined Utility System as permitted by the Master Ordinance (defined below). Capitalized terms used herein but not otherwise defined herein have the meanings given to such terms in APPENDIX C.

The Series 2009A Bonds will be issued for the purpose of refunding and defeasing certain of the City's outstanding Combined Utility System Commercial Paper Notes, Series A and the City's outstanding Combined Utility System First Lien Revenue Refunding Bonds, Series 2008D-2, reimbursing the CUS general purpose fund for previously expended project costs, depositing funds to the System's construction fund for project costs, funding required deposits to the debt service reserve fund, and paying the costs of issuance of the Series 2009A Bonds.

THE LIEN ON NET REVENUES OF THE SYSTEM SECURING THE SERIES 2009A BONDS IS SUBORDINATE TO THE LIEN SECURING PREVIOUS ORDINANCE BONDS IN AN AGGREGATE PRINCIPAL AMOUNT OF APPROXIMATELY $748.9 MILLION AS OF THE DATE OF THIS OFFICIAL STATEMENT. THE CITY WILL NOT ISSUE ANY ADDITIONAL BONDS OR OTHER OBLIGATIONS UNDER THE PREVIOUS ORDINANCE. SEE "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE" FOR FURTHER INFORMATION. THE SERIES 2009A BONDS DO NOT CONSTITUTE A GENERAL OBLIGATION OF THE CITY AND ARE NOT PAYABLE FROM FUNDS RAISED OR TO BE RAISED BY TAXATION.

The Series 2009A Bonds will be issued as fully registered securities and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository with respect to the Series 2009A Bonds. The Bank of New York Mellon Trust Company, National Association, Houston, Texas is to act as the initial paying agent for the Series 2009A Bonds.

The Series 2009A Bonds will be issued in authorized denominations of $5,000 principal amount and any integral multiple thereof. Interest on the Series 2009A Bonds will accrue from their date of delivery until maturity or prior redemption and is payable semiannually on each November 15 and May 15, commencing November 15, 2009.

The scheduled payment of the principal of and interest on the Series 2009A Bonds when due will be guaranteed under a municipal bond insurance policy to be issued concurrently with the delivery of the Series 2009A Bonds by Assured Guaranty Corp. See "BOND INSURANCE".

ASSURED GUARANTY®

The Series 2009A Bonds are subject to redemption as described herein. See "THE SERIES 2009A BONDS" herein.

SEE INSIDE COVER PAGE FOR MATURITY, PRICING SCHEDULES AND CUSIP NUMBERS

The Series 2009A Bonds are offered, when, as and if issued by the City, subject to the approving opinion of the Attorney General of Texas and the opinion of Andrews Kurth LLP, Houston, Texas, and Burney & Foreman, Houston, Texas, Co-Bond Counsel for the City, as to the validity of the issuance of the Series 2009A Bonds under the Constitution and laws of the State of Texas. Certain legal matters will be passed upon for the City by its Special Disclosure Co-Counsel, Fulbright & Jaworski L.L.P., Houston, Texas and Edgardo E. Colón, P.C. Houston, Texas, and for the Underwriters by their Co-Counsel, Vinson & Elkins, L.L.P., Houston, Texas and Bates & Coleman, P.C., Houston, Texas. The Series 2009A Bonds are expected to be available for delivery on or about April 9, 2009.

PIPER JAFFRAY & CO.

Banc of America Securities LLC **Loop Capital Markets LLC** **Morgan Stanley & Co. Incorporated**

Fidelity Capital Markets **Ramirez & Co., Inc.** **RBC Capital Markets** **Siebert Brandford Shank & Co. LLC** **Southwest Securities**

MATURITY, PRICING SCHEDULES AND CUSIP NUMBERS

$476,050,000
CITY OF HOUSTON, TEXAS
Combined Utility System First Lien Revenue and Refunding Bonds,
Series 2009A

CUSIP Prefix 442435[1]

Year[4] (November 15)	Maturity Amount	Interest Rate	Price/ Yield	CUSIP Suffix [1]
2014	$ 3,595,000	3.250%	3.000%	VA8
2015	2,695,000	3.500	3.230	VB6
2016	2,615,000	3.750	3.440	VC4
2017	2,705,000	4.000	3.660	VD2
2018	3,470,000	5.000	3.850	VE0
2019	3,645,000	5.000	4.040	VF7
2020	3,790,000	5.000	4.230[2]	VG5
2021	3,600,000	5.000	4.400[2]	VH3
2022	3,750,000	5.000	4.550[2]	VJ9
2023	3,625,000	5.000	4.710[2]	VK6
2024	3,955,000	5.250	4.870[2]	VL4
2025	3,415,000	5.250	5.010[2]	VM2
2026	13,155,000	5.500	5.110[2]	VN0
2027	14,090,000	5.500	5.210[2]	VP5
***	***	***	***	
2030	19,590,000	5.250	5.430	VS9
2031	22,485,000	5.250	5.500	VT7
2032	21,095,000	5.125	5.540	VQ3
2033	23,185,000	5.250	5.580	VW0
***	***	***	***	
2036	57,190,000	6.000	5.590[2]	VX8

$35,430,000 Term Bonds due November 15, 2029, 5.000% Yield 5.350% — CUSIP Suffix VR1[1][3]

$104,570,000 Term Bonds due November 15, 2035, 6.000% Yield 5.580% — CUSIP Suffix VU4[1][2][3]

$124,400,000 Term Bonds due November 15, 2038, 5.375% Yield 5.650% — CUSIP Suffix VV2[1][3]

(Interest accrues from Date of Delivery)

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[1] CUSIP numbers have been assigned to the Series 2009A Bonds by Standard & Poor's CUSIP Service Bureau, a Division of The McGraw-Hill Companies, Inc., and are included solely for the convenience of the owners of the Series 2009A Bonds. Neither the City, the Co-Financial Advisors nor the Underwriters are responsible for the selection or the correctness of the CUSIP numbers set forth herein. CUSIP is a registered trademark of the American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for CUSIP Services.

[2] The initial yield is calculated to the first optional redemption date.

[3] Subject to mandatory sinking fund redemption as described in "THE SERIES 2009A BONDS—Mandatory Redemption."

[4] The Series 2009A Bonds maturing on or after November 15, 2020 are subject to redemption prior to maturity, at the option of the City, on May 15, 2019 or any date thereafter. See "THE SERIES 2009A BONDS – Optional Redemption."

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACT. ANY REGISTRATION OR QUALIFICATION OF THE BONDS IN ACCORDANCE WITH APPLICABLE PROVISIONS OF SECURITIES LAWS OF THE STATES IN WHICH THE BONDS MAY HAVE BEEN REGISTERED OR QUALIFIED AND THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN OTHER STATES CANNOT BE REGARDED AS A RECOMMENDATION THEREOF.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE TERMS OF THIS OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THE BONDS HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City or the other matters described herein since the date hereof.

This Official Statement includes descriptions and summaries of certain events, matters and documents. Such descriptions and summaries do not purport to be complete and all such descriptions, summaries and references thereto are qualified in their entirety by reference to this Official Statement in its entirety and to each such document, copies of which may be obtained from the City or from the Co-Financial Advisors to the City. Any statements made in this Official Statement or the appendices hereto involving matters of opinion or estimates, whether or not so expressly stated, are set forth as such and not as representations of fact, and no representation is made that any of such opinions or estimates will be realized.

This Official Statement is delivered in connection with the sale of securities referred to herein and may not be reproduced or used, in whole or in part, for any other purposes.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Bonds in any jurisdiction in which it is unlawful to make such offer, solicitation or sale. No dealer, salesman or other person has been authorized by the City to give any information or to make any representation other than those contained herein, and, if given or made, such other information or representation must not be relied upon as having been authorized by the City or any other person. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create the implication that there has been no change in the matters described herein since the date hereof.

The prices and other terms respecting the offering and sale of the Bonds may be changed from time to time by the Underwriters after the Bonds are released for sale, and the Bonds may be offered and sold at prices other than the initial offering prices, including sales to Underwriters who may sell the Bonds into investment accounts.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Assured Guaranty makes no representation regarding the Series 2009A Bonds or the advisability of investing in the Series 2009A Bonds. In addition, Assured Guaranty has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding Assured Guaranty supplied by Assured Guaranty and presented under the heading "BOND INSURANCE" and "Appendix I - Specimen Financial Guaranty Insurance Policy".

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City of Houston, Texas

ELECTED OFFICIALS

Bill White, Mayor

Annise D. Parker, City Controller

CITY COUNCIL

Council Member, District A ..... Toni Lawrence
Council Member, District B ..... Jarvis Johnson
Council Member, District C ..... Anne Clutterbuck
Council Member, District D ..... Wanda Adams
Council Member, District E ..... Mike Sullivan
Council Member, District F ..... M.J. Khan, P.E.
Council Member, District G ..... Pam Holm
Council Member, District H ..... vacant*
Council Member, District I ..... James G. Rodriguez
Council Member, At-Large Position 1 ..... Peter Brown
Council Member, At-Large Position 2 ..... Sue Lovell
Council Member, At-Large Position 3 ..... Melissa Noriega
Council Member, At-Large Position 4 ..... Ronald C. Green
Council Member, At-Large Position 5 ..... Jolanda "Jo" Jones

APPOINTED OFFICIALS

Chief Administrative Officer ..... Anthony W. Hall, Jr.
City Attorney ..... Arturo G. Michel
Director, Department of Finance ..... Michelle Mitchell
Director, Department of Public Works and Engineering ..... Michael S. Marcotte
City Secretary ..... Anna Russell

CONSULTANTS AND ADVISORS

Co-Financial Advisors ..... Coastal Securities
Morgan Keegan & Co.
Estrada Hinojosa & Co., Inc.

Co-Bond Counsel ..... Andrews Kurth LLP
Burney & Foreman

Special Disclosure Co-Counsel ..... Fulbright & Jaworski L.L.P.
Edgardo E. Colón, P.C.

FINANCING WORKING GROUP MEMBERS

Legal Department ..... Susan T. Taylor
Gary L. Wood

Department of Finance ..... Charles R. Leal
Jennifer Mott

Office of the City Controller ..... James Moncur
Shawnell Holman-Smith

Department of Public Works and Engineering ..... Susan Bandy
Sophia Chang
Kate Bechtold

* On May 9, 2009, the City will hold a special election to fill the vacancy for the District H Council seat vacated by former City Council Member Adrian Garcia.

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OFFICIAL STATEMENT

$476,050,000
CITY OF HOUSTON, TEXAS
Combined Utility System
First Lien Revenue and Refunding Bonds,
Series 2009A

INTRODUCTION

This Official Statement provides certain information in connection with the issuance by the City of Houston, Texas (the "City") of its Combined Utility System First Lien Revenue and Refunding Bonds, Series 2009A (the "Bonds" or the "Series 2009A Bonds"). The Series 2009A Bonds are authorized to be issued pursuant to (i) Chapters 1201, 1207, 1371 and 1502, Texas Government Code, as amended, (ii) a master ordinance (the "Master Ordinance") adopted by the City Council of the City on April 21, 2004, (iii) a supplemental ordinance (the "Supplemental Ordinance") adopted by the City Council of the City on March 11, 2009, and (iv) an officers' pricing certificate authorized by the Supplemental Ordinance ("Officers' Pricing Certificate") dated as of the date hereof.

The Series 2009A Bonds are special obligations of the City payable as to principal, premium, if any, and interest solely from and secured by a lien on and pledge of Net Revenues (as defined herein), as collected and received, to be derived from operation of the City's combined utility system (the "System" or the "Combined Utility System"). The Combined Utility System currently consists of the City's water and sewer system (the "Water and Sewer System") and shall include such other utility systems that the City may from time to time elect to combine with the Combined Utility System so long as the revenues of such other utility systems are included in Gross Revenues of the Master Ordinance.

Brief descriptions and summaries of the Series 2009A Bonds, the City's Combined Utility System ("CUS"), the Master Ordinance and Supplemental Ordinance are included in this Official Statement. References to the Series 2009A Bonds, the Master Ordinance and the Supplemental Ordinance are qualified in their entirety by reference to such documents and the form of the Bonds included in the Supplemental Ordinance. The City's basic financial statements and the supplementary schedules for the City's Combined Utility System Fund for the fiscal year ended June 30, 2008, are included in APPENDIX A to this Official Statement. Capitalized terms used herein but not otherwise defined herein have the meanings given to such terms in APPENDIX C. Excerpts of the Master Ordinance are set forth in APPENDIX D. The form of Co-Bond Counsel Opinion is set forth as APPENDIX E. A listing of continuing disclosure schedules is included in APPENDIX F. Disclosure information pertaining to The Depository Trust Company is included in APPENDIX G. A description of Reserve Fund Surety Policies is included in APPENDIX H. A Specimen Bond Insurance Policy is included as APPENDIX I.

PURPOSE AND PLAN OF FINANCE

The Series 2009A Bonds are being issued to refund and defease approximately $300,000,000 of the City's outstanding Combined Utility System Commercial Paper Notes, Series A (the "Refunded Notes") and the City's outstanding Combined Utility System First Lien Revenue Refunding Bonds, Series 2008D-2 (the "Refunded Bonds" and together with the Refunded Notes, the "Refunded Obligations"), reimburse the CUS general purpose fund for previously expended project costs, deposit funds to the System's construction fund for project costs, fund the debt service reserve fund, and to pay costs of issuance of the Series 2009A Bonds and costs relating to refunding and defeasing the Refunded Obligations.

The Refunded Obligations

The Refunded Notes

The principal and interest on the Refunded Notes are to be paid in accordance with their terms with the proceeds of the Bonds, together with other available funds to be deposited with U.S. Bank National Association, the

paying agent for the Refunded Notes (the "Refunded Notes Paying Agent"). The City will deposit with the Refunded Notes Paying Agent a portion of the proceeds of the Bonds together with other funds, which will be sufficient to pay the principal of and interest on the Refunded Notes on the delivery date.

By making such deposits with the Refunded Notes Paying Agent, the City will have made firm banking and financial arrangements for the discharge and final payment of the Refunded Notes pursuant to the provisions of Chapter 1207, Texas Government Code, as amended. Thereafter, the Refunded Notes will be deemed to be fully paid and no longer outstanding and the lien on and pledge of net revenues of the Combined Utility System securing the Refunded Notes will be deemed to have been defeased pursuant to the terms of the Supplemental Ordinance authorizing the issuance of the Refunded Notes except for the purpose of being paid from the funds deposited with the Refunded Notes Paying Agent.

The Refunded Bonds

Portions of the proceeds of the Bonds, together with other available funds, if any, will be used to purchase a portfolio of obligations authorized under Texas law (the "Refunded Bond Escrowed Securities") to be deposited in escrow (the "Refunded Bond Escrow Fund") with The Bank of New York Mellon Trust Company, N.A. (the "Refunded Bond Escrow Agent"), the maturing principal of and interest on which will be sufficient together with other funds to pay, on the call date, the principal of and interest on the Refunded Bonds.

The accuracy of the mathematical computations of the adequacy of the maturing principal of and interest on the Refunded Bond Escrowed Securities, together with other available funds held in the Refunded Bond Escrow Fund, to provide for the payment of the Refunded Bonds will be verified by Grant Thornton LLP, a firm of independent certified public accountants. See "VERIFICATION OF MATHEMATICAL COMPUTATIONS."

In the opinion of Co-Bond Counsel for the City, by making the escrow deposits required by the Supplemental Ordinance authorizing the issuance of the Bonds and the escrow agreement to be entered into with the Refunded Bond Escrow Agent in connection with the Refunded Bonds (the "Refunded Bond Escrow Agreement"), the City will have made firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds pursuant to the provisions of Chapter 1207, Texas Government Code, as amended. Thereafter, the Refunded Bonds will be deemed to be fully paid and no longer outstanding and will have been deemed defeased pursuant to the terms of the ordinance authorizing the issuance of the Refunded Bonds, except for the purpose of being paid from the funds provided therefor pursuant to the Refunded Bond Escrow Agreement.

Simultaneously with the issuance of the Bonds, the City will give irrevocable instructions to the Refunded Bond Escrow Agent for the Refunded Bonds to provide notice to the owners of the Refunded Bonds. The Refunded Bonds will be redeemed on a date prior to their stated maturity on which date money held in the Refunded Bond Escrow Fund will be available to redeem the Refunded Bonds.

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SOURCES AND USES OF FUNDS

The following table summarizes the estimated sources and uses of proceeds of the Series 2009A Bonds:

Sources:	**Series 2009A Bonds**
Principal Amounts of Series 2009A Bonds	$476,050,000.00
Original Issue Discount	(2,278,774.85)
City Contribution	1,847,258.22
Total Sources of Funds	$475,618,483.37
Uses:	
Redemption of Refunded Notes	$301,438,880.14
Deposit to Escrow Fund for Refunded Bonds	24,068,378.07
Reimbursement of CUS General Purpose Fund	26,000,000.00
Deposit to Construction Fund	100,000,000.00
Deposit to Debt Service Reserve Fund	16,950,000.00
Issuance Expenses and Contingency[(1)]	4,592,185.91
Underwriters' Discount	2,569,039.25
Total Uses of Funds	$475,618,483.37

(1) Includes legal fees, financial advisory fees, rating agency fees, the bond insurance premium, and other costs of issuance.

REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE

The Master Ordinance provides that before any payments may be made on System Obligations, including First Lien Bonds such as the Series 2009A Bonds, all "Required Payments" must be made. The term "Required Payments" is defined in the Master Ordinance to mean any payments required to be made under the Previous Ordinance, including without limitation (i) all payments required to be made by the City as Maintenance and Operation Expenses under the Previous Ordinance, including without limitation under existing contracts on the effective date of the Master Ordinance for the impoundment, conveyance, or treatment of water or otherwise which are treated as operating expenses under the laws of the State of Texas, and (ii) all payments required to be made by the City to pay debt service requirements on Previous Ordinance Bonds in accordance with the terms of the Previous Ordinance and to comply with the reserve fund requirements of the Previous Ordinance. Approximately $748.9 million in aggregate principal amount of Previous Ordinance Bonds is currently outstanding. This amount does not include as of the date of this Official Statement $155.2 million accreted value of Previous Ordinance Bonds issued as capital appreciation bonds.

Existing contracts include the treated water supply contracts and a project contract with the Coastal Water Authority ("CWA") and the Trinity River Authority ("TRA"). CWA has issued bonds (the "Previously Issued Contract Revenue Bonds") secured by payments from the City under an amended and restated treated water supply contract. For further information see "SYSTEM DEBT AND CHARGES — Schedule 11 — Obligations Payable from System Revenues." See also "THE CITY AND THE SYSTEM — Water Facilities — Treated Water Supply Contracts."

Other than debt currently outstanding under the Previous Ordinance, the City has covenanted and agreed in the Master Ordinance not to issue any additional bonds or other obligations under the Previous Ordinance. See "CERTAIN COVENANTS AND TERMS OF THE MASTER ORDINANCE."

THE SERIES 2009A BONDS

Source of Payment

The Series 2009A Bonds are special obligations of the City that are equally and ratably payable from and secured by a lien on "Net Revenues" collected and received by the City after Required Payments with respect to Previous Ordinance Bonds issued by the City and payment of all Maintenance and Operation Expenses of the Combined Utility System. Net Revenues are required to be set aside for and pledged to the payment of the City's System Obligations, including the Series 2009A Bonds, all Additional Bonds and Qualified Hedge Agreements and Credit Agreements, including the Interest and Sinking Funds and the Reserve Funds required to be maintained for the payment of all such System Bonds and agreements, all as more fully described and provided for in the Master Ordinance. THE BONDS, TOGETHER WITH THE INTEREST THEREON, ARE PAYABLE SOLELY FROM SUCH NET REVENUES AND DO NOT CONSTITUTE AN INDEBTEDNESS OR GENERAL OBLIGATION OF THE CITY AND ARE NOT PAYABLE FROM FUNDS RAISED OR TO BE RAISED BY TAXATION. OWNERS OF THE SERIES 2009A BONDS SHALL NEVER HAVE THE RIGHT TO DEMAND PAYMENT THEREOF FROM THE LEVY OF AD VALOREM TAXES OR FROM ANY SOURCE NOT SPECIFICALLY PLEDGED TO PAYMENT OF THE SERIES 2009A BONDS. See "SECURITY FOR THE BONDS."

The lien on Net Revenues securing the System Obligations, including the Series 2009A Bonds, is subordinate to the lien securing the Previous Ordinance Bonds.

Description of the Bonds

The Series 2009A Bonds mature in the aggregate principal amount and on the dates indicated on the inside cover page of this Official Statement. Interest on the Series 2009A Bonds accrues from their date of delivery and is payable semiannually on November 15 and May 15 of each year, commencing November 15, 2009. The Series 2009A Bonds will be issued as fully registered bonds in denominations of $5,000 or any integral multiple thereof. The Bank of New York Mellon Trust Company, National Association, Houston, Texas, is the initial paying agent/registrar (the "Paying Agent/Registrar"). Interest on the Series 2009A Bonds is payable by check, or in the case of payment to DTC, by wire transfer of immediately available funds, to be mailed by the Paying Agent/Registrar on or before the interest payment date to the registered owners of record as of the first day of the month of the interest payment date. Principal of the Series 2009A Bonds is payable upon presentation and surrender thereof at the principal payment office of the Paying Agent/Registrar.

Optional Redemption

The Series 2009A Bonds maturing on or after November 15, 2020, are subject to redemption prior to maturity, at the option of the City, on May 15, 2019, or any date thereafter, in whole or in part, for a redemption price equal to 100% of their principal amount, plus accrued interest to the date fixed for redemption.

If an amount less than all of the Series 2009A Bonds is redeemed, the City may select the maturity or maturities to be redeemed. If less than all of any maturity of the Series 2009A Bonds is redeemed, the particular Series 2009A Bonds or portions thereof of such maturity to be redeemed will be selected by lot or other random method by the Paying Agent/Registrar in integral multiples of $5,000. In selecting for redemption portions of Series 2009A Bonds in denominations larger than $5,000, each such Series 2009A Bond will be treated as representing that number of the Series 2009A Bonds of $5,000 denomination which is obtained by dividing the principal amount of the Series 2009A Bonds by $5,000.

Mandatory Redemption

The Series 2009A Bonds maturing in the years 2029, 2035, and 2038 are subject to mandatory redemption prior to maturity in the following amounts (subject to reduction as provided in the Supplemental Ordinance), on the following dates, in each case at a redemption price equal to 100% of their principal amount plus accrued interest to the date fixed for redemption, if any:

$35,430,000 Term Bonds Maturing November 15, 2029

Redemption Date (November 15)	Redemption Amount
2028	$16,565,000
2029 (Maturity)	18,865,000

$104,570,000 Term Bonds Maturing November 15, 2035

Redemption Date (November 15)	Redemption Amount
2034	$50,715,000
2035 (Maturity)	53,855,000

$124,400,000 Term Bonds Maturing November 15, 2038

Redemption Date (November 15)	Redemption Amount
2037	$60,530,000
2038 (Maturity)	63,870,000

Notice of Redemption

At least 30 days prior to any redemption date, or such shorter period as may be allowed under DTC's book-entry-only system, which may be as short as but not less than seven days, a notice of redemption of the Series 2009A Bonds, identifying the Series 2009A Bonds to be redeemed, is required to be sent to the Registered Owners of the Series 2009A Bonds to be redeemed, at their addresses appearing in the records of the Paying Agent/Registrar, by first class mail, postage prepaid. Notice of redemption is also required to be sent by certified mail, return receipt requested, to at least two national information services, and any securities depository institution registered under the Securities Exchange Act of 1934, as amended, acting as securities depository under the Supplemental Ordinance. Each redemption notice is to contain the complete official name of the Series 2009A Bonds, CUSIP numbers, certificate numbers, redemption date, redemption price, redemption agent's name and address with a contact person's name and telephone number, date of issuance, maturity date and any other information appropriate to identify sufficiently the Series 2009A Bonds being redeemed.

Ownership

The City, the Paying Agent/Registrar and any other person may treat the person in whose name any Series 2009A Bond is registered (the "Registered Owner") as the absolute owner of such Series 2009A Bond for the purpose of making and receiving payment of the principal of, premium, if any, and interest on such Series 2009A Bond, for the purpose of giving notice to the Registered Owners thereof, and for all other purposes, whether or not such Series 2009A Bond is overdue. Neither the City nor the Paying Agent/Registrar shall be bound by any notice or knowledge to the contrary. All payments made to the Registered Owner of any Series 2009A Bond in accordance with the Supplemental Ordinance shall be valid and effectual and shall discharge the liability of the City and the Paying Agent/Registrar for such Series 2009A Bond to the extent of the sums paid.

Record Date

Interest on the Series 2009A Bonds is payable by check mailed by the Paying Agent/Registrar to the Registered Owner of record as of the 1st day of the month of the interest payment date as shown on the books of registration kept by the Paying Agent/Registrar.

Transfers and Exchanges

Beneficial ownership of Bonds registered in the name of The Depository Trust Company, New York, New York ("DTC") will be transferred initially as described under "APPENDIX G — THE DEPOSITORY TRUST COMPANY."

So long as any Bonds remain outstanding, the Paying Agent/Registrar shall keep the Register at its principal payment office in which, subject to such reasonable regulations as it may prescribe, the Paying Agent/Registrar shall provide for the registration and transfer of the Bonds in accordance with the terms of the Master Ordinance and the Supplemental Ordinance.

Each Bond shall be transferable only upon the presentation and surrender thereof by Cede & Co., as DTC's nominee or any subsequent Registered Owner, at the principal payment office of the Paying Agent/Registrar, duly endorsed for transfer, or accompanied by an assignment duly executed by Cede & Co., as DTC's nominee, or any subsequent Registered Owner or the authorized representative thereof in a form satisfactory to the Paying Agent/Registrar. Upon due presentation and surrender of a Bond for transfer, the Paying Agent/Registrar is required to authenticate and deliver in exchange therefor, within 72 hours after such presentation and surrender, a new Bond or Bonds, registered in the name of Cede & Co., as DTC's nominee, or such other transferee, in authorized denominations, of the same type, maturity and interest rate, and in the same aggregate Principal Amount, as the Bond or Bonds so presented and surrendered.

In the event the Bonds are not held in a book-entry registration system, all Bonds shall be exchangeable upon the presentation and surrender thereof at the principal payment office of the Paying Agent/Registrar for a Bond or Bonds of the same type, maturity and interest rate, in any authorized denomination and in an aggregate Principal Amount, equal to the Bond or Bonds presented for exchange. Bonds issued in exchange for other Bonds shall be entitled to the benefits and security of the Master Ordinance and the Supplemental Ordinance to the same extent as the Bond or Bonds in lieu of which such Bond is delivered.

The City or the Paying Agent/Registrar may require DTC or any subsequent Registered Owner of any Bond to pay a sum sufficient to cover any tax, fee, or other governmental charge that may be imposed in connection with the transfer or exchange of such Bond. Any fee or charge of the Paying Agent/Registrar for such transfer or exchange shall be paid by the City.

The Paying Agent/Registrar shall not be required to transfer or exchange any Bond called for redemption as follows during any period beginning 15 calendar days prior to the mailing of any notice of redemption; provided, however, that such restriction shall not apply to the transfer or exchange by Cede & Co., as DTC's nominee or any subsequent Registered Owner of the unredeemed portion of a Bond called for redemption in part.

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BOND INSURANCE

The following information is not complete and reference is made to Appendix I for a specimen of the financial guaranty insurance policy (the "Policy") of Assured Guaranty Corp. ("Assured Guaranty" or the "Insurer").

The Insurance Policy

Assured Guaranty has made a commitment to issue the Policy relating to the Series 2009A Bonds, effective as of the date of issuance of such Series 2009A Bonds. Under the terms of the Policy, Assured Guaranty will unconditionally and irrevocably guarantee to pay that portion of principal of and interest on the Series 2009A Bonds that becomes due for payment but shall be unpaid by reason of Nonpayment (the "Insured Payments"). Insured Payments shall not include any additional amounts owing by the City solely as a result of the failure by the Paying Agent to pay such amount when due and payable, including without limitation any such additional amounts as may be attributable to penalties or to interest accruing at a default rate, to amounts payable in respect of indemnification, or to any other additional amounts payable by the Paying Agent by reason of such failure. The Policy is non-cancelable for any reason, including without limitation the non-payment of premium.

"Due for Payment" means, when referring to the principal of the Series 2009A Bonds, the stated maturity date thereof, or the date on which such Series 2009A Bonds shall have been duly called for mandatory sinking fund redemption, and does not refer to any earlier date on which payment is due by reason of a call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity (unless Assured Guaranty in its sole discretion elects to make any principal payment, in whole or in part, on such earlier date) and, when referring to interest on such Series 2009A Bonds, means the stated dates for payment of interest.

"Nonpayment" means the failure of the City to have provided sufficient funds to the Paying Agent for payment in full of all principal and interest Due for Payment on the Series 2009A Bonds. It is further understood that the term Nonpayment in respect of a Bond also includes any amount previously distributed to the Holder (as such term is defined in the Policy) of such Bond in respect of any Insured Payment by or on behalf of the City, which amount has been recovered from such Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court having competent jurisdiction that such payment constitutes an avoidable preference with respect to such Holder. Nonpayment does not include nonpayment of principal or interest caused by the failure of the Paying Agent to pay such amount when due and payable.

Assured Guaranty will pay each portion of an Insured Payment that is Due for Payment and unpaid by reason of Nonpayment, on the later to occur of (i) the date such principal or interest becomes Due for Payment, or (ii) the business day next following the day on which Assured Guaranty shall have received a completed notice of Nonpayment therefor in accordance with the terms of the Policy. Assured Guaranty shall be fully subrogated to the rights of the Holders of the Series 2009A Bonds to receive payments in respect of the Insured Payments to the extent of any payment by Assured Guaranty under the Policy.

The Policy is not covered by any insurance or guaranty fund established under New York, California, Connecticut or Florida insurance law.

The Insurer

Assured Guaranty is a Maryland-domiciled insurance company regulated by the Maryland Insurance Administration and licensed to conduct financial guaranty insurance business in all fifty states of the United States, the District of Columbia and Puerto Rico. Assured Guaranty commenced operations in 1988. Assured Guaranty is a wholly owned, indirect subsidiary of Assured Guaranty Ltd. ("AGL"), a Bermuda-based holding company whose shares are publicly traded and are listed on the New York Stock Exchange under the symbol "AGO." AGL, through its operating subsidiaries, provides credit enhancement products to the U.S. and global public finance, structured finance and mortgage markets. Neither AGL nor any of its shareholders is obligated to pay any debts of Assured Guaranty or any claims under any insurance policy issued by Assured Guaranty.

Assured Guaranty is subject to insurance laws and regulations in Maryland and in New York (and in other jurisdictions in which it is licensed) that, among other things, (i) limit Assured Guaranty's business to financial guaranty insurance and related lines, (ii) prescribe minimum solvency requirements, including capital and surplus requirements, (iii) limit classes and concentrations of investments, (iv) regulate the amount of both the aggregate and individual risks that may be insured, (v) limit the payment of dividends by Assured Guaranty, (vi) require the maintenance of contingency reserves, and (vii) govern changes in control and transactions among affiliates. Certain state laws to which Assured Guaranty is subject also require the approval of policy rates and forms.

Assured Guaranty's financial strength is rated "AAA" (stable) by Standard & Poor's, a division of The McGraw-Hill Companies, Inc., "AAA" (stable) by Fitch, Inc. and "Aa2" (stable) by Moody's Investors Service, Inc. Each rating of Assured Guaranty should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any security, and such ratings are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of any security guaranteed by Assured Guaranty. Assured Guaranty does not guaranty the market price of the securities it guarantees, nor does it guaranty that the ratings on such securities will not be revised or withdrawn.

Recent Developments

On November 14, 2008, AGL announced that it had entered into a definitive agreement to purchase Financial Security Assurance Holdings Ltd. ("FSA"), the parent of financial guaranty insurance company Financial Security Assurance, Inc. For more information regarding the proposed acquisition by AGL of FSA, see the Annual Report on Form 10-K filed by AGL with the Securities and Exchange Commission (the "SEC") on February 26, 2009.

Capitalization of Assured Guaranty Corp.

As of December 31, 2008, Assured Guaranty had total admitted assets of $1,803,146,295 (unaudited), total liabilities of $1,425,012,944 (unaudited), total surplus of $378,133,351 (unaudited) and total statutory capital (surplus plus contingency reserves) of $1,090,288,113 (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of December 31, 2007, Assured Guaranty had total admitted assets of $1,361,538,502 (audited), total liabilities of $961,967,238 (audited), total surplus of $399,571,264 (audited) and total statutory capital (surplus plus contingency reserves) of $982,045,695 (audited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. The Maryland Insurance Administration recognizes only statutory accounting practices for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under the Maryland Insurance Code, and for determining whether its financial condition warrants the payment of a dividend to its stockholders. No consideration is given by the Maryland Insurance Administration to financial statements prepared in accordance with accounting principles generally accepted in the United States in making such determinations.

Incorporation of Certain Documents by Reference

The portions of the following documents relating to Assured Guaranty are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof:

(i) The Annual Report on Form 10-K of AGL for the fiscal year ended December 31, 2008 (which was filed by AGL with the SEC on February 26, 2009); and

(ii) The Current Reports on Form 8-K filed by AGL with the SEC, as they relate to Assured Guaranty.

All consolidated financial statements of Assured Guaranty and all other information relating to Assured Guaranty included in documents filed by AGL with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, subsequent to the date of this Official Statement and prior to the

termination of the offering of the Series 2009A Bonds shall be deemed to be incorporated by reference into this Official Statement and to be a part hereof from the respective dates of filing such consolidated financial statements.

Any statement contained in a document incorporated herein by reference or contained herein under the heading "BOND INSURANCE" shall be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any subsequently filed document which is incorporated by reference herein also modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

Copies of the consolidated financial statements of Assured Guaranty incorporated by reference herein and of the statutory financial statements filed by Assured Guaranty with the Maryland Insurance Administration are available upon request by contacting Assured Guaranty at 1325 Avenue of the Americas, New York, New York 10019 or by calling Assured Guaranty at (212) 974-0100. In addition, the information regarding Assured Guaranty that is incorporated by reference in this Official Statement that has been filed by AGL with the SEC is available to the public over the Internet at the SEC's web site at *http://www.sec.gov* and at AGL's web site at *http://www.assuredguaranty.com*, from the SEC's Public Reference Room at 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549, and at the office of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

SECURITY FOR THE BONDS

Set forth below is a description of the revenues pledged to the payment of the Series 2009A Bonds, the flow of funds and rate covenant contained in the Master Ordinance and a summary of certain security provisions of the Master Ordinance applicable to the Series 2009A Bonds. Capitalized terms used in this section but not otherwise defined in this section have the meanings assigned to such terms in "APPENDIX C — Definitions." For further information, see "APPENDIX D — Excerpts of the Master Ordinance."

Pledge of Net Revenues

The Series 2009A Bonds are special obligations of the City payable from and secured by a lien on Net Revenues as collected and received by the City from the operation and ownership of the Combined Utility System. ***The lien on Net Revenues securing the Series 2009A Bonds is subordinate to the lien securing the Previous Ordinance Bonds.***

In the Master Ordinance, the City covenants and agrees that Gross Revenues of the System shall, as collected and received by the City, be deposited and paid into the special funds established by the Master Ordinance after satisfying any requirements of the Previous Ordinance, including the payment of all Required Payments. For so long as the Previous Ordinance Bonds remain Outstanding, the City covenants and agrees that gross revenues (as defined under the Previous Ordinance) shall be applied in the manner set forth in the Previous Ordinance to provide for the payment of all Required Payments, and then Gross Revenues shall be applied in the manner set forth in the Master Ordinance to provide for the payment of all remaining Maintenance and Operation Expenses that have not been paid as Required Payments. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE." The Master Ordinance provides that resulting Net Revenues are to be applied to the payment of principal of, interest on and any redemption premiums on the First Lien Bonds, any parity System Obligations under Qualified Hedge Agreements and Credit Agreements and all expenses of paying same and then provides for the disposition of the remaining Net Revenues in accordance with the Master Ordinance.

First Lien Bonds, including the Series 2009A Bonds, are special obligations of the City that are payable solely from and (together with parity Qualified Hedge Agreement and Credit Agreement obligations) are equally and ratably secured by a first lien on the Net Revenues as collected and received by the City from the operation and ownership of the Combined Utility System. The Master Ordinance provides that Net Revenues are required to be set aside in the First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund for and pledged to the payment of the First Lien Bonds and parity System Obligations, and the First Lien Bonds are, in all respects, on a parity with and of equal dignity with one another, except that the City may elect that one or more series of Additional Bonds issued as First Lien Bonds will not share in the benefits of the First Lien Bond Reserve Fund.

THE SERIES 2009A BONDS DO NOT CONSTITUTE A GENERAL OBLIGATION OF THE CITY AND ARE NOT PAYABLE FROM ANY FUNDS RAISED OR TO BE RAISED BY TAXATION. OWNERS OF THE FIRST LIEN BONDS, INCLUDING THE SERIES 2009A BONDS, SHALL NEVER HAVE THE RIGHT TO DEMAND PAYMENT THEREOF FROM THE LEVY OF AD VALOREM TAXES OR FROM ANY OTHER SOURCE NOT PLEDGED TO THE PAYMENT OF THE FIRST LIEN BONDS.

The Master Ordinance provides that Chapter 1208, Texas Government Code, as amended, applies to the issuance and delivery of First Lien Bonds, including the Series 2009A Bonds and the pledge of the Net Revenues granted under the Master Ordinance, and such pledge is therefore valid, effective and perfected.

The Master Ordinance defines "Net Revenues" to mean (i) all Gross Revenues remaining after deducting Maintenance and Operation Expenses, plus (ii) any Restricted Receipts deposited to the Revenue Fund that may be used to pay Debt Service Requirements on System Obligations. The Master Ordinance defines "Restricted Receipts" to mean (i) revenues related to the Combined Utility System received by the City that pursuant to law or contractual agreements may not be used to pay Maintenance and Operation Expenses and (ii) any interest earnings on the revenues described in clause (i) above.

The Master Ordinance defines "Gross Revenues" to mean all revenues and income of every nature now and hereafter derived or received by the City from the operation and ownership of the components of the Combined Utility System; the interest income from the investment or deposit of money in the funds created pursuant to the Master Ordinance and the Previous Ordinance; and any other revenues pledged to the payment of System Obligations issued pursuant to the Master Ordinance and the Previous Ordinance. The term "Gross Revenues" also includes all payments received by the City, except for termination payments and receipts of collateral, pursuant to Qualified Hedge Agreements. For the definition of "Maintenance and Operation Expenses," see APPENDIX C.

The Master Ordinance permits the City to issue certain subordinate lien obligations (secured by liens on Net Revenues subordinate and inferior to the First Lien Bonds); and to provide Reserve Fund Surety Policies (as defined below) in lieu of making cash deposits to the Bond Reserve Funds, all as more fully described below.

Special Funds

The Master Ordinance provides that the following special Funds are to be established and accounted for by the City while the Series 2009A Bonds and any other System Bonds remain Outstanding:

(i) Revenue Fund;

(ii) First Lien Bond Interest and Sinking Fund;

(iii) First Lien Bond Reserve Fund;

(iv) Second Lien Bond Interest and Sinking Fund;

(v) Second Lien Bond Reserve Fund;

(vi) Third Lien Obligation Interest and Sinking Fund;

(vii) Third Lien Obligation Reserve Fund (if and when required);

(viii) Fourth Lien Obligation Interest and Sinking Fund (if and when required);

(ix) Fourth Lien Obligation Reserve Fund (if and when required);

(x) Interest and Sinking Funds and Reserve Funds for any additional System Obligations that will be junior and subordinate to Fourth Lien Obligations (if and when required); and

(xi) CUS General Purpose Fund.

The Master Ordinance provides that the Funds listed above are to be maintained as separate accounts on the books of the City. The First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund are required to be held in trust under the Master Ordinance for the Owners of the First Lien Bonds (and parity System Obligations, if any, under Qualified Hedge Agreements and Credit Agreements) and the proceeds of which (except for interest income, which shall be transferred to the Revenue Fund) are pledged to the payment of the First Lien Bonds (and parity Qualified Hedge Agreements and Credit Agreements). In the Master Ordinance, the City reserves the right to establish additional funds and accounts necessary or desirable for the efficient administration of the System.

Flow of Funds

The Master Ordinance provides that after making any Required Payments in accordance with the terms of the Previous Ordinance, Gross Revenues of the Combined Utility System are to be deposited as collected into the Revenue Fund, and applied as follows: to (i) pay Maintenance and Operation Expenses, to the extent not already paid, and (ii) establish and maintain an operating reserve equal to two months' budgeted Maintenance and Operation Expenses. The remaining balance, together with Restricted Receipts, shall be applied in the following manner and in the following order of priority:

(i) First, to make all deposits into the First Lien Bond Interest and Sinking Fund on the dates and in the amounts required by the Master Ordinance or any Supplemental Ordinance authorizing First Lien Bonds (in order to provide for the full and timely payment of all principal of, interest on and any redemption premiums on all First Lien Bonds and parity System Obligations, if any, under Qualified Hedge Agreements and Credit Agreements);

(ii) Second, to make all deposits into the First Lien Bond Reserve Fund on the dates and in the amounts required by the Master Ordinance or any Supplemental Ordinance authorizing First Lien Bonds (in order to establish and maintain a debt service reserve for the timely payment of the Series 2009A Bonds and all other First Lien Bonds and parity System Obligations, if any, under Qualified Hedge Agreements and Credit Agreements that the City elects to be secured by the First Lien Bond Reserve Fund (collectively, the "Reserve Fund Participants"), and to make any required payments on repayment obligations incurred pursuant to a Reserve Fund Surety Policy (as defined below));

(iii) Third, to make all deposits into the Second Lien Bond Interest and Sinking Fund on the dates and in the amounts required by the Master Ordinance or any Supplemental Ordinance authorizing Second Lien Bonds (in order to provide for the full and timely payment of the principal of, interest on and any redemption premiums on all Second Lien Bonds and parity System Obligations, if any, under Qualified Hedge Agreements and Credit Agreements);

(iv) Fourth, to make all deposits into the Second Lien Bond Reserve Fund on the dates and in the amounts required by the Master Ordinance or any Supplemental Ordinance authorizing Second Lien Bonds (in order to establish and maintain a debt service reserve for the timely payment of all Second Lien Bonds and parity System Obligations, if any, under Qualified Hedge Agreements and Credit Agreements and to make any required payments on repayment obligations incurred pursuant to a Reserve Fund Surety Policy);

(v) Fifth, to make all payments and deliveries required by the Master Ordinance or any Supplemental Ordinance authorizing obligations secured by liens on and pledges of Net Revenues subordinate and inferior to the First Lien Bonds and Second Lien Bonds (the "Third Lien Obligations"), including the City's obligations to deliver collateral and make termination payments under Qualified Hedge Agreements that are not payable in installments over the remaining term of the relevant transaction (in order to provide for the payment of and security for such Third Lien Obligations);

(vi) Sixth, to make all payments and deliveries required by the Master Ordinance or any Supplemental Ordinance authorizing obligations secured by liens on and pledges of Net Revenues subordinate and inferior to the First Lien Bonds, Second Lien Bonds and Third Lien Obligations (the "Fourth Lien Obligations") (in order to provide for the payment of and security for such Fourth Lien Obligations); and

(vii) Seventh, to make deposits of any remaining Net Revenues into the CUS General Purpose Fund. See "—CUS General Purpose Fund."

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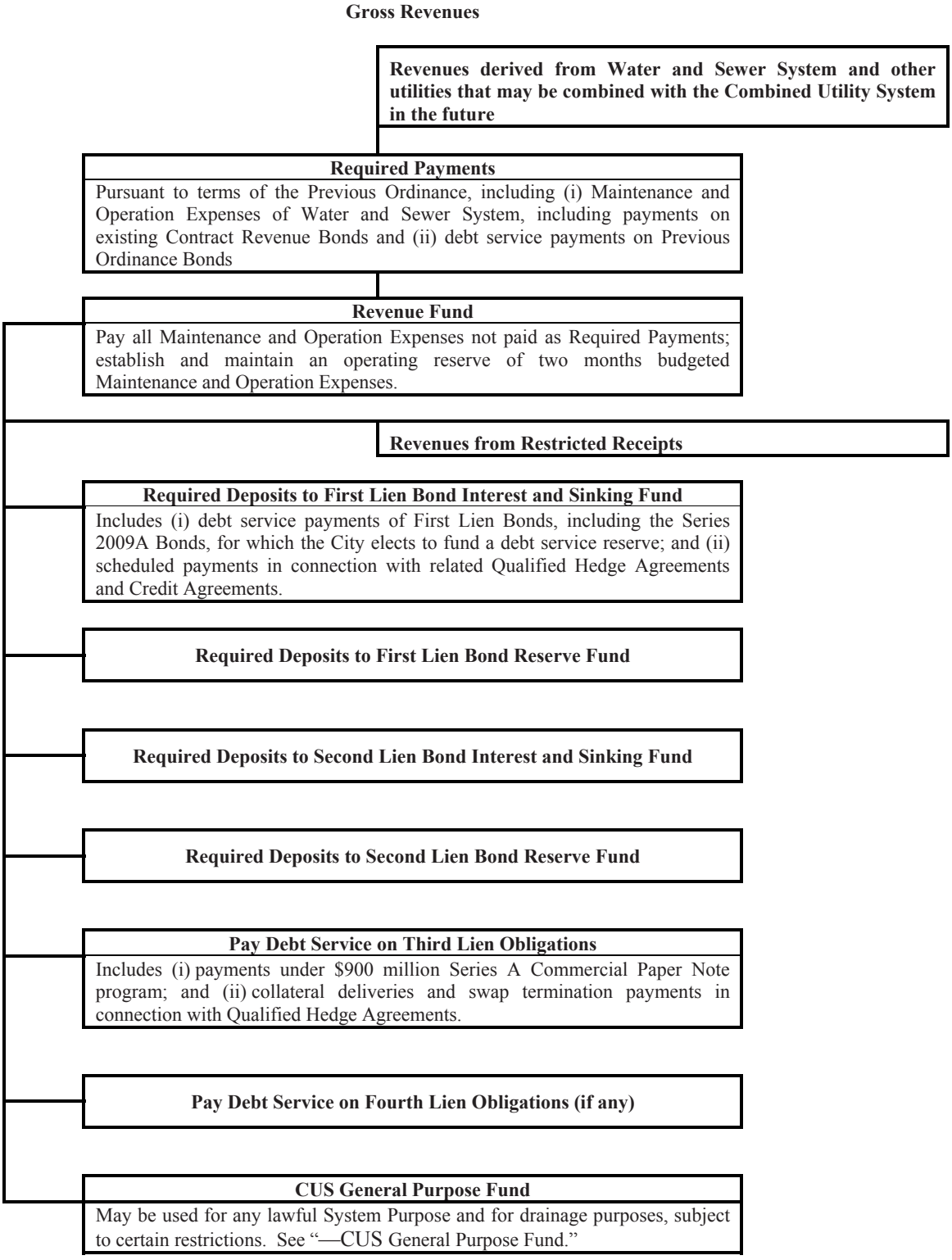
FLOW OF FUNDS (APPLICATION OF REVENUES)
Under Provisions of the Master Ordinance
HOUSTON COMBINED UTILITY SYSTEM



First Lien Bond Interest and Sinking Fund

The Master Ordinance provides that on or before the last Business Day immediately preceding (i) an Interest Payment Date while any Series 2009A Bonds or other First Lien Bonds remain Outstanding, and (ii) any date when any payments are due and payable under a Qualified Hedge Agreement relating to First Lien Bonds, there shall be transferred into the First Lien Bond Interest and Sinking Fund from the Revenue Fund, the following amounts:

(a) Such amounts as will be sufficient to pay the amount of interest scheduled to become due on the First Lien Bonds on such Interest Payment Date; plus

(b) Such amounts, if any, as will be sufficient to pay the amount of principal of the First Lien Bonds due on such Interest Payment Date, including the principal amounts of, and any redemption premiums on, any First Lien Bonds payable as a result of the operation or exercise of any mandatory or optional redemption provision contained in any Supplemental Ordinance authorizing First Lien Bonds; plus

(c) Such amounts, if any, as shall be necessary to pay fees, charges and other amounts payable to the Paying Agent/Registrar and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider or Qualified Hedge Agreement provider which, by terms of their agreements with the City, are payable from the First Lien Bond Interest and Sinking Fund.

Moneys credited to the First Lien Interest and Sinking Fund shall be used solely for the purpose of paying interest on, principal (at maturity or prior redemption or to purchase First Lien Bonds issued as term bonds in the open market to be credited against mandatory redemption requirements) of and redemption premiums on the First Lien Bonds, plus all fees, charges and other amounts payable to the Paying Agent/Registrar, and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider or Qualified Hedge Agreement provider which, by the terms of their agreements with the City, are payable from the First Lien Bond Interest and Sinking Fund. On or before each date principal becomes due and/or each Interest Payment Date on the First Lien Bonds, the City is required to transfer from the First Lien Bond Interest and Sinking Fund to the Paying Agent/Registrar in immediately available funds an amount equal to the principal and interest payable on the First Lien Bonds on such date.

First Lien Bond Reserve Fund

The Supplemental Ordinance authorizing the Series 2009A Bonds provides that the Reserve Fund Requirement for the Reserve Fund Participants (the "First Lien Participant Reserve Requirement") shall be an amount equal to 50% of the Maximum Annual Debt Service Requirements on (i) all First Lien Bonds issued through the date of the Supplemental Ordinance authorizing the Series 2009A Bonds, and (ii) all subsequent issues of First Lien Bonds for which the City elects to fund a shared Bond Reserve Fund on a parity with the Bond Reserve Fund funded by such Supplemental Ordinance. All such issues electing the First Lien Participant Reserve Requirement will be entitled to a parity claim on the funds deposited in the shared Bond Reserve Fund.

The Master Ordinance provides that on or before the last Business Day of each month so long as any First Lien Bonds that are Reserve Fund Participants remain Outstanding, there shall be transferred into the First Lien Bond Reserve Fund from the Revenue Fund amounts equal to one-sixtieth (1/60th) of the First Lien Participant Reserve Requirement unless or until there has been accumulated in the First Lien Bond Reserve Fund money and investments in an aggregate amount at least equal to the First Lien Participant Reserve Requirement; provided that additional deposits into the First Lien Bond Reserve Fund sufficient to provide for the increased First Lien Participant Reserve Requirement resulting from the issuance of any Additional First Lien Bonds that are Reserve Fund Participants shall be made by not later than 60 months from the date of issuance of such Additional First Lien Bonds. After such amount has accumulated in the First Lien Bond Reserve Fund and so long thereafter as such Fund contains such amount, no further deposits shall be required to be made into the First Lien Bond Reserve Fund, and any excess amounts in such Fund may be transferred to the Revenue Fund. But if and whenever the balance in the First Lien Bond Reserve Fund is reduced below such amount, monthly deposits into such Fund shall be resumed and continued in amounts at least equal to one-sixtieth (l/60th) of the First Lien Participant Reserve Requirement until the First Lien Bond Reserve Fund has been restored to such amount. The First Lien Bond Reserve Fund shall

be used to pay the principal of and interest on the First Lien Bonds that are Reserve Fund Participants (and parity System Obligations, if any, under related Qualified Hedge Agreements and Credit Agreements) at any time when there is not sufficient money available in the First Lien Bond Interest and Sinking Fund for such purpose, and it may be used finally to pay and retire the last First Lien Bonds that are Reserve Fund Participants to mature or be redeemed.

The Master Ordinance provides that the requirements of the immediately preceding paragraph notwithstanding, the City may provide a Reserve Fund Surety Policy issued in amounts equal to all or part of the First Lien Participant Reserve Requirement in lieu of depositing cash into the First Lien Bond Reserve Fund. In the event a Reserve Fund Surety Policy issued to satisfy all or a part of the City's obligation with respect to the First Lien Bond Reserve Fund causes the amount then on deposit in the First Lien Bond Reserve Fund to exceed the First Lien Participant Reserve Requirement, the City may transfer such excess amount to any fund or funds established for the payment of or security for First Lien Bonds, the Second Lien Bonds, or any Third Lien Obligations or Fourth Lien Obligations (including any escrow established for the final payment of any such Obligations preceding an Interest Payment Date pursuant to Chapter 1207, Texas Government Code, as amended), or to the CUS General Purpose Fund.

The Series 2009A Bonds will be issued as First Lien Bonds for the purpose of refunding the Refunded Bonds and the Refunded Notes. See "PURPOSE AND PLAN OF FINANCE." Accordingly, the First Lien Participant Reserve Requirement will increase in connection with the issuance of the Series 2009A Bonds, and the City will deposit cash in the Debt Service Reserve Fund in an amount sufficient to satisfy any such increase. For a discussion of amounts held in the Debt Service Reserve Fund and the existing Reserve Fund Surety Policies issued in connection with certain outstanding First Lien Bonds and Previous Ordinance Bonds, see the section captioned "RESERVE FUND." See also "APPENDIX H—Description of Reserve Fund Surety Policies."

CUS General Purpose Fund

The Master Ordinance provides that subject to the payment to the provider of a First Lien Participants Reserve Fund Surety Policy of any interest on amounts advanced and any expenses incurred under the Reserve Fund Surety Policy required to be paid pursuant to an agreement between the City and the provider of such Reserve Fund Surety Policy, from any moneys remaining in the Revenue Fund, at least annually within 90 days following the end of each Fiscal Year, there shall be set aside and credited to the CUS General Purpose Fund, the remaining revenues in the Revenue Fund. Moneys accounted for in the CUS General Purpose Fund, subject to any limitations in the Master Ordinance or in any other contract pertaining to such account, may be withdrawn in any priority for any one, all, or any combination of the following:

(i) Capital Costs. To pay the costs of constructing or otherwise acquiring any betterments of, enlargement of, extensions of, or any other improvements to the System, or any part thereof, and any equipment therefor, authorized by law;

(ii) Major Maintenance Costs. To pay the costs of extraordinary and major repairs, renewals, replacements, or maintenance items pertaining to any properties of the System of a type not recurring annually or at shorter intervals and not paid as Maintenance and Operation Expenses;

(iii) Debt Service Requirements. To pay any System Bonds or other System Obligations or securities pertaining to the System and payable from Net Revenues (regardless of whether such securities are secured by a lien thereon), as to Debt Service Requirements and any other appurtenant charge pertaining to such Debt Service Requirements on any Interest Payment Date, or any redemption date or redemption dates, or by purchase in the open market, or by creating an escrow to provide for the payment of or to defease such System Bonds, other System Obligations or securities or otherwise;

(iv) Legal Obligations. To pay any obligations pertaining to the System and arising from a judgment against the City or any officer, employee, or other agent of the City acting within the scope of his official duties, rights, or privileges, or the scope of his employment, as the case may be, in any suit, action, or special proceedings in equity or at law, in any court of competent jurisdiction, or a settlement by the City of any claim to avoid or to settle such a suit, action, or special proceedings, except to the extent revenues are otherwise available to defray such an obligation, including, without limitation, insurance proceeds, or to

pay any penalties, fines, settlements or other amounts required to be paid by the City as a result of federal or state administrative proceedings relating to the System;

(v) Assumed and Other Obligations. To pay any bonds or other obligations assumed by the City which were issued or incurred by water districts annexed and dissolved by the City, which bonds or other obligations are by their own terms secured in whole or in part by a pledge of water or sewer revenues which did not terminate upon the annexation and dissolution of such water districts, and other bonds or obligations issued or assumed by the City for combined utility system purposes which are payable from ad valorem taxes or sources other than the First Lien Bond Interest and Sinking Fund, the First Lien Bond Reserve Fund, the Second Lien Bond Interest and Sinking Fund, or the Second Lien Bond Reserve Fund;

(vi) Lawful System Purposes. For any other lawful purposes of the System as the City may determine; and

(vii) Drainage Purposes. For planning, design, construction, regulation, improvement, repair, maintenance, and operation of facilities and programs relating to the system or network of storm water management facilities including, but not limited to, inlets, conduits, manholes, channels, ditches, drainage easements, retention and detention basin, infiltration facilities, and other components, including, without limitation, the costs of developing, implementing, and enforcing a storm water management program to reduce the discharge of pollutants from the City's storm sewer system and protect water quality, and the costs related to obtaining, renewing, or maintaining any required permits related to the operation of the storm sewer system, and also including payment of debt service on bonds, notes or other obligations issued for the purposes listed in this paragraph; provided that the aggregate amount withdrawn from the CUS General Purpose Fund for such purposes in this sub-paragraph (vii) during any Fiscal Year shall not exceed 8% of the Gross Revenues of the System for the immediately preceding Fiscal Year.

The Master Ordinance provides that moneys shall be withdrawn from the CUS General Purpose Fund for any one, all, or other combination of such purposes designated above in the same manner that other claims against the System are presented and paid. Amounts in the CUS General Purpose Fund at the beginning of a Fiscal Year which are deposited into the Revenue Fund in that Fiscal Year are Gross Revenues for the Fiscal Year in which such amounts are deposited into the Revenue Fund.

Rate Covenant

The Master Ordinance provides that while any First Lien Bonds, including the Series 2009A Bonds, and any other System Bonds remain Outstanding, the City is required to fix, charge, and collect rates and charges for the use and services of the System that are calculated to be fully sufficient to produce Net Revenues in each Fiscal Year at least equal to the greater of:

(i) 120% of the combined Debt Service Requirements scheduled to occur in such Fiscal Year on all Previous Ordinance Bonds and First Lien Bonds then Outstanding, or

(ii) 110% of the combined Debt Service Requirements scheduled to occur in such Fiscal Year on all Previous Ordinance Bonds, First Lien Bonds and Second Lien Bonds then Outstanding,

plus an amount equal to the sum of all deposits required to be made to the First Lien Bond Reserve Fund and to the Second Lien Bond Reserve Fund in such Fiscal Year; provided that in calculating the Net Revenues required by paragraphs (i) and (ii) above all or any portion of such Net Revenues that exceed 100% of the combined Debt Service Requirements may be attributed to amounts on deposit in the CUS General Purpose Fund that are available to pay Debt Service Requirements (see "SECURITY FOR THE BONDS — CUS General Purpose Fund — Debt Service Requirements"), and provided further that in no event shall Net Revenues ever be less than the amount required to establish and maintain the First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund as provided in the Master Ordinance, to establish and maintain the Second Lien Bond Interest and Sinking Fund and the Second Lien Bond Reserve Fund as provided in the Master Ordinance and, to the extent that funds for such purpose are not otherwise available, to pay all other Outstanding System Obligations payable from the Net Revenues of the System, including all amounts owed as a repayment obligation by the City pursuant to a Reserve Fund Surety Policy or a Credit Agreement, as and when the same become due. The foregoing provision of the

Master Ordinance is referred to as the "Rate Covenant." The Master Ordinance provides that the calculation required by this section shall be made annually at the time the City's annual budget for the System is adopted and shall be included in the annual budget for the System.

Automatic Annual Rate Adjustments

The Master Ordinance provides that on April 1 of each year (subject to the terms of existing contracts, the requirements of the Rate Covenant, applicable Texas law and the authority of the City Council of the City to adopt other rates and charges as limited by Proposition 1 as described in "THE CITY AND THE SYSTEM-City Charter and Tax Revenue Limitations") rates and charges for the use and services of the System shall be adjusted based on the percentage change (if any) in the Designated Index or other appropriate index for the preceding calendar year. The Master Ordinance defines the term "Designated Index to mean the United States Consumer Price Index for all Urban Consumers (also known as the CPI-U) for the Houston-Galveston-Brazoria, Metropolitan Area (1982-1984=100), as published by the Bureau of Labor Statistics, U.S. Department of Labor (but if such is subject to adjustment later, then the later adjusted index, together with any correlation factor necessary to relate the later adjusted index to the earlier index, as published by the entity publishing the index, shall be used), or if such publication is discontinued, the Designated Index shall then refer to comparable statistics on changes in the cost of living for urban consumers as the same may be computed and published (on the most frequent basis available) by an agency of the United States or by a responsible financial periodical of recognized authority, which agency or periodical shall be selected by the City. See "RATES."

On March 11, 2009, the City Council of the City approved a one-time increase to the water and sewer rates above the annual automatic rate adjustment based on the percentage change in the Designated Index. This increase reflects the 1.79% growth in the City's population for one year (based on the published estimates of the U.S. Census Bureau for the most recently available twelve month period) and is in conformance with Proposition 1. Proposition 1 permits increases, without voter approval, to water and sewer rates up to the cumulative amount of the Designated Index and population growth. Since 2004, annual rate adjustments have only reflected the change in the Designated Index. See "THE CITY AND THE SYSTEM—City Charter Tax and Revenue Limitations" for a discussion of Proposition 1, other propositions, and the status of related litigation.

ADDITIONAL BONDS

Set forth below is a description of the Additional Bonds Test contained in the Master Ordinance and certain provisions relating to the issuance of other System Obligations under the Master Ordinance. Capitalized terms used in this section but not otherwise defined in this section have the meanings assigned to such terms in "APPENDIX C — Definitions." For more complete information, see "APPENDIX D — Excerpts of the Master Ordinance."

Additional First Lien and Second Lien Obligations

Bonds. In the Master Ordinance, the City reserves the right to issue, for any lawful System purpose, including the refunding of any previously issued First Lien Bonds, Second Lien Bonds or Previous Ordinance Bonds or any other bonds or obligations of the City issued in connection with the System or payable from Net Revenues, or to pay obligations incurred under or pursuant to any Credit Agreement or Qualified Hedge Agreement, one or more series of (i) Additional First Lien Bonds on a parity with the Outstanding First Lien Bonds payable from, and secured by a first lien on, the Net Revenues of the System senior and superior to the lien securing the Second Lien Bonds; and (ii) Additional Second Lien Bonds on a parity with the Outstanding Second Lien Bonds; provided, however, that no Additional First Lien Bonds or Additional Second Lien Bonds may be issued unless:

(a) The First Lien Bond Reserve Fund (and, for the issuance of Additional Second Lien Bonds, the Second Lien Bond Reserve Fund) each contains the amount of money then required to be on deposit therein;

(b) For either the preceding Fiscal Year or any consecutive 12-month period out of the 18-month period immediately preceding the month in which the Supplemental Ordinance authorizing such Additional First Lien Bonds or Additional Second Lien Bonds, as the case may be, is adopted (the "Base Period") either:

(i) Net Revenues are certified by the City Controller to have been equal to not less than the greater of (A) 120% of the combined Maximum Annual Debt Service Requirements on all First Lien Bonds and any Previous Ordinance Bonds or (B) 110% of the combined Maximum Annual Debt Service Requirements on all First Lien Bonds, Second Lien Bonds, and any Previous Ordinance Bonds, after giving effect to the issuance of the Additional First Lien Bonds or Additional Second Lien Bonds to be issued; or

(ii) Net Revenues, adjusted to give effect to any rate increase, new customers, or annexation of territory placed into effect or consummated prior to the adoption of the ordinance authorizing the Additional First Lien Bonds or Additional Second Lien Bonds, as the case may be, to the same extent as if such rate increase, new customers, or annexation had been placed into effect or consummated prior to the commencement of the Base Period, would have been equal to at least the greater of (A) or (B) in paragraph (i) above, as certified by an independent consulting engineer or independent firm of consulting engineers;

provided that (1) all or any portion of the Net Revenues required by clauses (i) and (ii) of paragraph (b) above that exceed 100% of the Maximum Annual Debt Service Requirements may be attributed to amounts on deposit in the CUS General Purpose Fund that are available to pay Debt Service Requirements; (2) the provisions of this paragraph (b) shall not apply to the issuance of any series of Additional Second Lien Bonds for the purpose of refunding Outstanding First Lien Bonds, or to the issuance of any series of Additional First Lien Bonds or Additional Second Lien Bonds for refunding purposes, that will not have the result of increasing the Average Annual Debt Service Requirements on the First Lien Bonds or the Second Lien Bonds; and (3) the provisions of this paragraph (b) shall not apply to the issuance of Additional First Lien Bonds for the purpose of refunding Short Term Obligations issued as First Lien Bonds or the issuance of Additional Second Lien Bonds for the purpose of refunding Short Term Obligations issued as First Lien Bonds or Second Lien Bonds; and

(c) Provision is made in the Supplemental Ordinance authorizing the Additional First Lien Bonds or Additional Second Lien Bonds then proposed to be issued for (i) additional payments into the First Lien Bond Interest and Sinking Fund or Second Lien Bond Interest and Sinking Fund, as the case may be, sufficient to provide for the payment of the increased principal of and interest on the First Lien Bonds or Second Lien Bonds resulting from the issuance of such Additional First Lien Bonds or Additional Second Lien Bonds, and (ii) additional payments into the First Lien Bond Reserve Fund (if such Bonds are Reserve Fund Participants) or Second Lien Bond Reserve Fund, as the case may be, sufficient to provide for the accumulation therein of the increased Reserve Fund Requirements, if any, resulting from the issuance of such Additional First Lien Bonds or Additional Second Lien Bonds, by not later than 60 months from the date of issuance of such Additional First Lien Bonds or Additional Second Lien Bonds.

Credit Agreements. The City may enter into Credit Agreements with respect to any System Bonds or Qualified Hedge Agreements if:

(i) prior to entering into such Credit Agreement, the City, to the extent required by law, shall cause the proceedings authorizing the Credit Agreement and any contracts or reimbursement agreements relating thereto to be submitted to and approved by the Attorney General of Texas; and

(ii) for any Credit Agreement that obligates the City to make any future payments for the availability of such Credit Agreement, the City's financial advisor must certify in a written certificate delivered to the City that the inclusion of such payments within the Debt Service Requirements on the System Bonds or Qualified Hedge Agreement to which the Credit Agreement relates will not cause such System Bonds or Qualified Hedge Agreement to fail to comply with the applicable coverage requirements for their issuance or incurrence.

The issuer of any Credit Agreement is entitled to be subrogated to the rights of the Owners of the System Bonds or the counterparty to the Qualified Hedge Agreement secured by such Credit Agreement, and the City's reimbursement and repayment obligations to the issuer of the Credit Agreement shall be secured by Net Revenues as provided in the Master Ordinance.

Qualified Hedge Agreements. The City may enter into Qualified Hedge Agreements in connection with any System Bonds for any purpose authorized by law if the following requirements are satisfied:

(iii) the proceedings authorizing the Qualified Hedge Agreement and any contracts or reimbursement agreements relating thereto shall, to the extent required by law, be submitted to and approved by the Attorney General of Texas; and

(iv) the City's financial advisor shall certify in a written certificate delivered to the City that the System Bonds to which the Qualified Hedge Agreement relates could have been issued in satisfaction of all of the coverage requirements of Article Six of the Master Ordinance if the Debt Service Requirements with respect to such System Bonds are recalculated (as provided in the definition of Debt Service Requirements) to take into account the Qualified Hedge Agreement.

The Master Ordinance defines the term "Maximum Annual Debt Service Requirements" to mean the greatest combined Debt Service Requirements (taking into account all mandatory principal redemption requirements) scheduled to occur in any particular future Fiscal Year or in the then current Fiscal Year for the particular System Bonds (First Lien Bonds, Second Lien Bonds, Previous Ordinance Bonds or any combination of the foregoing) for which such calculation is made.

Short Term Obligations

In the Master Ordinance, the City reserves the right to issue, from time to time, one or more series of Additional First Lien Bonds and/or Additional Second Lien Bonds as Short Term Obligations in accordance with the provisions described in "ADDITIONAL BONDS — Additional First Lien and Second Lien Obligations."

Third Lien Obligations and Fourth Lien Obligations

In the Master Ordinance, the City also reserves the right to issue, for any lawful purpose, Third Lien Obligations secured in whole or in part by liens on Net Revenues that are junior and subordinate to the liens on Net Revenues securing payment of the First Lien Bonds and the Second Lien Bonds. The City also reserves the right to issue Fourth Lien Obligations secured in whole or in part by liens on Net Revenues that are junior and subordinate to the liens on Net Revenues securing payment of First Lien Bonds, Second Lien Bonds, and Third Lien Obligations. The City has established a $900 million Series A Commercial Paper Note program that provides for the issuance of Commercial Paper Notes as Third Lien Obligations. The Series 2009A Bonds are being issued in part for the purpose of refunding and defeasing a portion of the outstanding Refunded Notes. See "PURPOSE AND PLAN OF FINANCE."

Supplemental Ordinance

The Master Ordinance provides that System Bonds will be issued pursuant to a Supplemental Ordinance stating the purpose of the issuance, directing the application of proceeds and containing the terms of the issuance, including the date, principal amount, maturities, designation, interest rates, redemption privileges and other provisions. The Master Ordinance provides that Third Lien Obligations, Fourth Lien Obligations, Qualified Hedge Agreements and Credit Agreements will be issued pursuant to Supplemental Ordinances or pursuant to separate ordinances that provide for the timing of transfers of funds from the Revenue Fund to the debt service funds and reserve funds, if any, established for such System Obligations consistent with the order of priority set forth in the Master Ordinance.

Special Project Obligations

The City also reserves the right in the Master Ordinance to issue revenue bonds secured by liens on and pledges of revenues and proceeds derived from Special Projects. The Master Ordinance defines Special Projects to mean, to the extent permitted by law, any existing or future utility system property, improvement or facility declared by the City not to be part of the System, for which the costs of acquisition, construction, and installation are paid from proceeds of a financing transaction other than the issuance of bonds payable from ad valorem taxes or revenues of the System and for which all maintenance and operation expenses are payable from sources other than ad valorem taxes or revenues of the System, but only to the extent that and for so long as all or any part of the revenues or proceeds of which are or will be pledged to secure the payment or repayment of such costs of acquisition, construction, and installation under such financing transaction.

CERTAIN COVENANTS AND TERMS OF THE MASTER ORDINANCE

The following section describes certain covenants and other terms of the Master Ordinance. Capitalized terms used in this section but not otherwise defined have the meanings given to such terms in "APPENDIX C — Definitions." For additional information, see "APPENDIX D — Excerpts of the Master Ordinance." See also the sections captioned "SECURITY FOR THE BONDS" and "ADDITIONAL BONDS."

Restrictions on Free Service

The City has covenanted in the Master Ordinance not to permit any free service from the System except for public buildings and institutions operated by the City and properties permitted to be exempt by state law. Additionally, the City will not permit any free service which would violate any condition or covenant to which the City is bound in connection with any federal grant agreement or otherwise.

Bondholder Rights and Remedies

The Master Ordinance is a contract between the City and the Owners of the System Bonds, including the Series 2009A Bonds. The Master Ordinance remains irrepealable until the System Bonds are fully paid, discharged or defeased as provided in the Master Ordinance. In the event of a default in the payment of any System Bonds or a default in the performance of any duty or covenant provided by law or in the Master Ordinance, the Owners of System Bonds may pursue all legal remedies afforded by the Constitution and laws of the State of Texas to compel the City to remedy such default and to prevent further defaults. Any Owner of System Bonds may at law or in equity, by suit, mandamus or other proceedings, enforce performance of all duties required by the City under the Master Ordinance, including the making and collection of reasonable and sufficient rates and charges for the use of the System and the deposit and application of revenues in the manner required in the Master Ordinance. A Supplemental Ordinance may provide that, so long as an issuer of a municipal bond insurance policy has not defaulted in its payment obligations under such policy with the City insuring a portion of the System Bonds, that issuer shall at all times be deemed to be the exclusive owner of such System Bonds for the purpose of all approvals, consents, waivers or institution of any action and the direction of all remedies.

Defeasance

The City may defease the provisions of the Master Ordinance and discharge its obligation to the Owners of System Bonds or other System Obligations in any manner permitted by law, including by depositing with the Paying Agent/Registrar, or if authorized by Texas law with any national or state bank having trust powers and having combined capital and surplus of at least $50 million or with the Comptroller of Public Accounts of the State of Texas either: (a) cash in an amount equal to the principal amount and redemption premium, if any, of such System Bonds or other System Obligations plus interest thereon to the date of maturity or redemption, or (b) pursuant to an escrow or trust agreement, cash and/or securities authorized by Texas law at the time of issuance of such series of System Bonds or System Obligations, including currently (1) direct noncallable obligations of the United States, including obligations that are unconditionally guaranteed by the United States; (2) noncallable obligations of an agency or instrumentality of the United States, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that, on the date the City adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent; and (3) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that, on the date the City adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent.

Such deposits may be invested only in obligations described above that are in principal amounts and maturities and bear interest at rates sufficient to provide for the timely payment of the principal amount and redemption premium, if any, of such System Bonds or other System Obligations plus interest thereon to the date of maturity or redemption. Upon such deposit and upon receipt of an opinion of nationally recognized bond counsel to the effect that such System Bonds or System Obligations are deemed to be fully paid and are no longer outstanding, such System Bonds or other System Obligations shall no longer be regarded to be Outstanding or unpaid. Any surplus amounts not required to accomplish such defeasance shall be returned to the System after the System

Obligations are retired. Payments on any System Obligations made by a provider of a Credit Agreement insuring a portion of the System Obligations will not be deemed to have been paid under the Master Ordinance, and such System Obligations shall continue to be Outstanding until paid by the City.

Amendments to Ordinance

The Master Ordinance provides that the City may, with the consent of Owners holding a majority in aggregate principal amount of the System Bonds then Outstanding affected thereby, amend, add to, or rescind any of the provisions of the Master Ordinance; provided that, without the consent of all Owners of Outstanding System Bonds, no such amendment, addition, or rescission shall (1) extend the time or times of payment of the principal of, premium, if any, and interest on the System Bonds, or reduce the principal amount thereof, the redemption price therefor, or the rate of interest thereon, (2) give any preference to any System Bond over any other System Bond, or (3) reduce the aggregate principal amount of System Bonds required to be held by Owners for consent to any such amendment, addition, or rescission. The Master Ordinance provides that for the purposes of this amendment provision, the Owners of the System Bonds shall include the initial Owners regardless of whether such System Bonds are being held for subsequent resale.

Reservation of Right to Issue Board Bonds on a Parity with Previous Ordinance Bonds

In the Master Ordinance the City reserved the right to issue a specified amount of Board Bonds to the Texas Water Development Board on a parity with the Previous Ordinance Bonds. The City has issued the full amount of Board Bonds reserved under the Master Ordinance that are on parity with the Previous Ordinance Bonds and covenants and agrees in the Master Ordinance not to issue any other bonds or other obligations under the terms of the Previous Ordinance that would be senior in priority to First Lien Bonds, including the Series 2009A Bonds.

QUALIFIED HEDGE AGREEMENTS

Master Ordinance Requirements

The Master Ordinance permits the City to enter into Qualified Hedge Agreements such as interest rate swap agreements, currency swap agreements, forward payment conversion agreements and futures contracts, among others. A Qualified Hedge Agreement may only be entered into with an institution that has long term credit ratings, or the obligations of which are unconditionally guaranteed by a financial institution with long term credit ratings, in one of the two highest generic rating categories by at least one Rating Agency then rating the System Bonds. Each Qualified Hedge Agreement shall be payable from and secured by a pledge of Net Revenues of the System on the same priority as the System Bonds of the series to which it relates, except that any obligation of the City to deliver collateral or make termination payments that are not payable in installments over the remaining life of the relevant transaction will be payable from and secured by a pledge of Net Revenues on a parity with Third Lien Obligations. However, the Master Ordinance provides that issuers of and counterparties to Qualified Hedge Agreements will not be treated as Owners of System Bonds for purposes of any voting rights to approve amendments under the Master Ordinance.

Qualified Hedge Agreements for Series 2008A Bonds

The City entered into a Qualified Hedge Agreement (a "Series 2008A Qualified Hedge Agreement") with a notional amount of $249,075,000 in an effort to mitigate and hedge interest rate exposure on the applicable series of Series 2008A Bonds which were issued as adjustable rate bonds. The Series 2008A Qualified Hedge Agreement was separately entered into with the Royal Bank of Canada ("RBC" or the "Series 2008A Counterparty").

Under the Series 2008A Qualified Hedge Agreement between the City and RBC, the City synthetically converts the adjustable rate on the underlying bonds to a net fixed rate liability. The City's scheduled swap payments under the Series 2008A Qualified Hedge Agreement with RBC are insured by Ambac.

Qualified Hedge Agreements for Series 2004B Bonds

The City entered into three separate Qualified Hedge Agreements (each a "Series 2004B Qualified Hedge Agreement") with an aggregate notional amount of $653,325,000 to substantially convert the adjustable rate on the

Series 2004B Bonds to a net fixed rate liability. Each Series 2004B Qualified Hedge Agreement was separately entered into with the following counterparties (each a "Series 2004B Counterparty"): Goldman Sachs Capital Markets LP (with a guaranty by The Goldman Sachs Group, Inc.), Bear Stearns Financial Products Inc. and UBS AG. The Series 2004B Bonds were converted from an auction rate mode to a weekly mode as of April 14, 2008. The scheduled obligations of the City under the Series 2004B Qualified Hedge Agreements with JPMorgan Chase are insured by XL Capital Assurance Inc.

General Provisions of the Qualified Hedge Agreements

The City and the respective Series 2004B or Series 2008A Counterparty may each terminate a Series 2004B or Series 2008A Qualified Hedge Agreement if the other party (or, in some cases, its credit support provider or specified affiliate) commits an event of default (including under other specified transactions and indebtedness) or certain acts of insolvency, or may not legally perform its obligations under the agreement, or the other party's (or its credit support provider's) long-term ratings are downgraded below "A3" or "A-" (in the case of the Series 2004B or Series 2008A Counterparty) or "Baa2" or "BBB" (in the case of the City) by the rating agencies that rate such party. The City has no obligation to pledge collateral under any of these Qualified Hedge Agreements unless the respective counterparties have the right to terminate and the System's credit ratings are downgraded below "Baa2" or "BBB".

The counterparties have the right to terminate their respective Series 2004B or Series 2008A Qualified Hedge Agreement if the long term debt ratings of the System fall below specified ratings (based on the ratings of the City or the respective swap insurer), or the respective insurer fails to meets its payment obligations under either of the Qualified Hedge Agreements, or an insurer event coupled with another termination event or an event of default has occurred and, among other possible remedies, the City fails to deliver a letter establishing the long term rating of the System Obligations as "Baa2", "BBB", or the equivalent or better. The respective insurer generally must consent to the exercise of and, under certain circumstances, may exercise the parties' termination rights. If either party terminates a Series 2004B or Series 2008A Qualified Hedge Agreement, the terminating party generally must pay to or be paid by the defaulting or affected party the mean or median average of amounts quoted by leading dealers to be paid to or by the terminating party to enter into an economically equivalent agreement with it, regardless of which party was the defaulting or affected party. Under Texas law, any City obligation to make a termination payment may be financed by the issuance of additional System Bonds.

The City's obligations to make net payments under Series 2004B or Series 2008A Qualified Hedge Agreements are payable from and secured by a pledge of Net Revenues of the System on a parity with First Lien Bonds, except that the pledge securing the City's obligations to deliver collateral and make termination payments are subordinate and on a parity with Third Lien Obligations. Any amounts received by the City under a Series 2004B or Series 2008A Qualified Hedge Agreement will be revenues of the System. The City could be subject to additional payments under the Series 2004B Qualified Hedge Agreements or the Series 2008A Qualified Hedge Agreement with RBC if there is a shortfall in its LIBOR-based gross receivables compared to its tax-exempt variable rate interest obligations on the applicable Series 2004B or Series 2008A Bonds. Any substantial shortfall could result in the need to increase rates and charges. If the City is required to make substantial termination payments or to deliver substantial amounts of collateral, the liquidity of the System could be adversely affected, depending on market conditions. The City may also enter into other interest rate hedging transactions payable from System revenues in the future, with comparable risks.

For additional information, see Note 8.C.14 to 8.C.15 to the City's audited financial statements presented in APPENDIX A.

SYSTEM NET REVENUES AVAILABLE FOR DEBT SERVICE

Schedule 1 — Net Revenues of the System and Debt Service Coverage

The following schedule sets forth the Net Revenues of the System for Fiscal Years ended June 30, 2007 and 2008, together with the extent to which such Net Revenues covered debt service on Junior Lien Bonds under the Previous Ordinance, First Lien Bonds under the Master Ordinance and other system debt then outstanding. The debt service amounts and coverage ratios set out in this schedule do not include the Series 2009A Bonds (see "PURPOSE AND PLAN OF FINANCE") or Third Lien Obligations issued as Commercial Paper Notes under the Master Ordinance (see "SYSTEM DEBT AND CHARGES — Commercial Paper Program"). The amounts shown for Fiscal Year 2008 and Fiscal Year 2007 are taken from the audited financial statements for the City's Combined Utility System and from the supplementary information and statistical section included in the City Controller's Comprehensive Annual Financial Report of the City of Houston, Texas, for each respective Fiscal Year.

	Fiscal Year	
	2008 (in thousands)	2007 (in thousands)
OPERATING REVENUES[1]:		
Sales of Water, net	$328,435	$308,046
Sewer system user charges, net	305,748	295,423
Penalties, other services and charges	14,084	11,996
Total Operating Revenues	648,267	615,465
NON-OPERATING REVENUES[1]		
Investment Earnings under Previous Ordinance	27,417	24,031
Investment Earnings under Master Ordinance	8,019	11,983
Non-Operating Revenues: Water Authority Contributions	7,212	1,054
Other non-operating revenues	18,625	9,597
Total non-operating revenues	61,273	46,665
TOTAL GROSS REVENUES:	709,540	662,130
EXPENSES[1]		
Contract Revenue Bond Payments[2]	32,267	41,873
Maintenance and Operating Expenses	347,358	326,939
Total Expenses	379,625	368,812
RESTRICTED RECEIPTS UNDER MASTER ORDINANCE	20,398	26,707
NET REVENUES UNDER MASTER ORDINANCE	$350,313	$320,025
BOND DEBT SERVICE:		
Previously Issued Bonds	$62,023	$61,314
First Lien Bonds	209,327	184,568
Total Debt Service	$271,350	$245,882
BOND DEBT SERVICE COVERAGE:		
Junior Lien Bond Coverage under Previous Ordinance[3]	5.19x	4.59x
First Lien Bond Coverage under Master Ordinance[4]	1.38x	1.40x
TOTAL COVERAGE [5]	1.29x	1.30x

[1] See text that follows for a discussion comparing revenues and expenses for Fiscal Years 2007 and 2008.
[2] See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."
[3] Coverage of debt service on Previous Ordinance Bonds by Net Revenues as calculated under Previous Ordinance, which does not include as revenues Restricted Receipts and investment earnings under the Master Ordinance.
[4] Coverage of Debt Service on First Lien Bonds by Net Revenues, less debt service on Junior Lien Bonds under Previous Ordinance.
[5] Coverage of total Debt Service on Junior Lien Bonds under Previous Ordinance and First Lien Bonds under Master Ordinance by Net Revenues.

Revenues and expenses of the System can be impacted by the effects of weather, with dry weather generally resulting in an increase of usage of the facilities of the System, which can increase both revenues and expenses, and higher than average rainfall amounts generally resulting in less demand for the facilities of the System.

Schedule 2 — Coverage of Maximum Annual Debt Service by Net Revenues

The following calculation shows coverage by Net Revenues of Maximum Annual Debt Service on the Previous Ordinance and First Lien Bonds.

Maximum Annual Debt Service Requirements on Previous Ordinance Bonds (2019) [1]	$139,219,336
Maximum Annual Debt Service Requirements on First Lien Bonds (2032) [1] [2]	376,457,692
Combined Maximum Annual Principal and Interest Requirements on Previous Ordinance Bonds and First Lien Bonds(2015)[1] [2]	377,943,524
Net Revenues under Previous Ordinance for Fiscal Year ended June 30, 2008[3]	321,896,000
Net Revenues under Master Ordinance for Fiscal Year ended June 30, 2008[4]	350,313,000
Funds available from General Purpose Fund at June 30, 2008	184,314,367
Total Funds available for Debt Service Coverage	534,627,367
Coverage of Maximum Annual Debt Service Requirements on Previous Ordinance	2.31
Coverage of Maximum Annual Debt Service Requirements on First Lien Bonds	1.42
Coverage of Combined Maximum Annual Debt Service Requirements[5]	1.41

(1) Does not include debt service on CWA, which are payable from Gross Revenues as a Maintenance and Operating Expense of the System.

(2) Series 2004B debt service is adjusted to take into account expected payments under the Series 2004B Qualified Hedge Agreements. The Series 2008A variable rate bond debt service is calculated at the fixed payor swap rate of 3.761%. Debt service on the Series 2008D Bonds is calculated based on an assumed taxable rate with a maturity on the applicable tax-exempt conversion date. After the applicable Tax-Exempt Conversion Date, debt service is calculated using a long term tax-exempt rate to maturity.

(3) Excludes Investment Earnings under Master Ordinance and Restricted Receipts under Master Ordinance.

(4) Net Revenues as calculated under the Master Ordinance, which includes as revenues Restricted Receipts and earnings under the Master Ordinance.

(5) Coverage under Master Ordinance for combined debt service on Previous Ordinance Bonds and First Lien Bonds.

THE CITY AND THE SYSTEM

General

The Combined Utility System established under the Master Ordinance currently consists of the City's groundwater and surface water sources and conveyance, treatment and distribution facilities (the "Water Facilities") and wastewater collection and treatment facilities (the "Sewer Facilities"). The Water Facilities and Sewer Facilities are sometimes collectively referred to as the "Water and Sewer Facilities." The Combined Utility System may include other utility systems provided for in Chapter 1502, Texas Government Code, as amended, which the City may from time to time elect to combine with the Combined Utility System so long as the revenues of such other utility systems are included in Gross Revenues under the Master Ordinance.

Governmental Structure

The City has a mayor-council form of government in which the Mayor and the fourteen-member City Council serve as the legislative body. Nine council members are elected by district and five council members are elected at-large. The Mayor, all members of the City Council and the City Controller are elected for two-year terms. The present term of office for all elected officials expires in January 2010. The City Charter limits the terms of office for all elected City officials to three two-year terms. On May 9, 2009, the City will hold a special election to fill the vacancy for the District H Council seat, vacated by former City Council Member Adrian Garcia.

The Mayor is the City's chief executive officer. The Mayor exercises administrative control over the City's government; presides over City Council meetings; establishes the City Council agenda; and appoints the heads of the various departments of the City, subject to confirmation by the City Council. The Mayor also is responsible for preparing and submitting the City's annual budget proposals to the City Council for adoption.

The City Controller is the City's chief financial officer. The Office of the City Controller superintends, supervises, manages and conducts the fiscal affairs of the City; maintains the books of accounts; prepares financial statements; conducts the sales of City obligations; certifies the availability of funds before the City incurs any financial obligation; and, along with the Mayor, countersigns all warrants, contracts or orders for payment of any money by the City.

Redistricting

Two registered voters in the City have recently filed a lawsuit against the Mayor, City Controller and the members of the City Council alleging that the results of municipal elections held after 2006, when the City's population reached 2.1 million per published estimates of the U.S. Census Bureau for 2006, are void and unenforceable because they failed to reflect the addition of two single-member City Council districts, as required by the City Charter (the "Redistricting Requirement"). If the City added the two single-member City Council districts, preclearance of such change to the City Council by the U.S. Department of Justice under Section 5 of the federal Voting Rights Act would be required. Plaintiffs seek a declaration that the City's failure to conduct voting in compliance with the Redistricting Requirement renders all elections conducted by the City since 2006, and all future City elections conducted without addition of the two new single-member districts, legally void and unenforceable. The Plaintiffs are seeking a permanent injunction restraining the City from any further actions requiring voter approval of issues or measures related to governance of the City, including the proposed District H special vacancy election called for May 9, 2009, as well as the regular City general election to be held on November 3, 2009, as required by the City Charter, until the City has fulfilled the Redistricting Requirement.

The City intends to contest this lawsuit vigorously. The City's position is that the federal decennial census is the only reliable indication of the population levels of the City's Council districts, and accordingly, a redistricting to add two single-member Council districts must await the results of the 2010 census. The City has various other defenses, including whether, under the facts they assert, the law permits the plaintiffs to sue under the preclearance provisions of the Voting Rights Act.

City Charter Tax and Revenue Limitations

In an election held in November 2004, a majority of the voters voted for both Proposition 1 and Proposition 2, but Proposition 1 received more favorable votes than Proposition 2. Because of language contained in Proposition 1 and the City Charter, the City believes that Proposition 1 is effective and Proposition 2 is not. However, the Controller has verified that the Fiscal Year 2009 Budget complies with Proposition 1 and would comply with Proposition 2. In response to these tax and revenue limitations, the City held an election on November 7, 2006 at which the voters approved Proposition G and Proposition H, which are currently effective. The City has incorporated Propositions G and H into its financial policies, and it anticipates collecting revenues and making expenditures for public safety purposes in compliance with Proposition H.

Proposition 1. Proposition 1 limits increases in (i) the City's ad valorem tax revenues by requiring voter approval for increases in ad valorem taxes in future years above a limit equal to the lesser of the actual revenues in the preceding Fiscal Year, plus 4.5%, or a formula that is based upon the actual revenues received in Fiscal Year 2005 adjusted for the cumulative combined rates of inflation and the City's population growth; and (ii) water and sewer rates by limiting rate increases to the combined increases in the rates of inflation and population growth, excluding rate increases required by certain bond covenants and rates established by contract, unless approved by the voters.

Proposition 2. Proposition 2 would limit increases in the City's "combined revenues," which would include revenues of the general fund, special revenue funds and enterprise funds, excluding only grant monies and revenues from other governmental entities. Proposition 2 would require 60% voter approval at a regular election to increase combined revenues over the combined revenues for the immediately preceding Fiscal Year, adjusted for the rates of change in the consumer price index (the "CPI") for the Houston area and the City's population. If the actual increase in the amounts of combined revenues for any given Fiscal Year is less than the allowable increase, then such reduced amount of combined revenues received by the City would be the baseline for the next Fiscal Year. If in any year the City's "combined revenues" exceed the amount allowed by Proposition 2, then the City would be required to deposit such excess in a taxpayer relief fund. If the balance in the taxpayer relief fund reaches $10 million, such amount would be required to be refunded to taxpayers. Proposition 2 includes a provision that states that the City shall honor its covenants with bondholders such that shortfalls in debt coverage, among other covenants, shall be made up from reductions in other expenditures.

Proposition G. Proposition G amends the City Charter to exclude revenues of the City's enterprise systems (i.e. Combined Utility System, Houston Airport System, and the Convention and Entertainment Facilities Department) from the types of revenues limited under the City Charter. Voter approval of Proposition G removed the enterprise systems from the revenue limitations of Proposition 2, although the limitation on water and sewer rate increases included in Proposition 1 remains in effect.

Proposition H. Proposition H allows the City to collect and spend up to $90 million of revenue, over and above any Proposition 2 limitations, for increased police, fire and emergency medical services and related communications and dispatch costs. The amount collected and spent in each year becomes part of the base revenue calculations for the following year.

Status of Litigation. Certain supporters of Proposition 2 filed a lawsuit in State district court seeking a declaratory judgment that Proposition 2 is valid and enforceable. On January 9, 2006, the district court granted the plaintiffs' motion for summary judgment. The City appealed the ruling to the Fourteenth Court of Appeals, and on April 3, 2008, the Fourteenth Court of Appeals reversed the State district court's summary judgment and remanded the case for further proceedings, finding that the plaintiffs did not have standing to sue. The plaintiffs in that litigation subsequently filed a petition for review in the Texas Supreme Court and the City filed a response. In early January 2009, the Texas Supreme Court requested that the parties submit briefing on the merits of the case. Unless the Texas Supreme Court grants the petition and reverses the Fourteenth Court's ruling or the plaintiffs can amend their pleadings in the district court to demonstrate standing, the case will be decided in favor of the City. The City does not believe that the plaintiffs will be able to demonstrate sufficient facts to cause the court to grant them standing. A State district court recently dismissed an action by a voter of the City that sought to invalidate Propositions G and H. The plaintiff has appealed the ruling, and the briefing in that appeal to the First Court of Appeals has been completed.

Response to Hurricane Ike

On September 13, 2008, the Houston area suffered severe wind damage and some flooding as a result of Hurricane Ike. The Department estimates that the cost for storm related clean up and repairs to the System was approximately $20 million. As of the date of this Official Statement, all clean up is finished, permanent repairs are underway, and the System is fully operational. The Department continues to work with the Federal Emergency Management Agency and its insurance providers to ensure reimbursement of such costs. However, even if such costs are not reimbursed, the Department does not foresee an impact to the System's ability to meet all its financial obligations.

Administration of the System

The System is operated by the Department of Public Works and Engineering (the "Department"). The management of the Department is under the supervision of the following persons:

Michael S. Marcotte, Director of the Department of Public Works and Engineering, assumed his duties in July 2004. Mr. Marcotte has over 30 years of experience within the public and private sectors of the civil infrastructure industry. Prior to assuming his present duties with the City, Mr. Marcotte was the chief engineer and deputy general manager of the District of Columbia Water and Sewer Authority. At the Authority he was responsible for five operating divisions and the Capital Improvements Program. He previously served as director of the Dallas Economic Development Department, director of Dallas Water Utilities, acting director of the Planning and Development Department, and chief of maintenance and chief engineer for the City's Public Works Department, Water Division. He was also a senior manager with the Houston consulting firm Turner, Collie and Braden, Inc. Mr. Marcotte holds a Bachelor of Arts degree in Environmental Science and Engineering and a Masters of Environmental Science degree from Rice University. He is a registered Professional Engineer in the State of Texas.

Jun Chang, Interim Deputy Director – Public Utilities, assumed his duties in September, 2008. Mr. Chang is responsible for operating and maintaining the City of Houston's regional water and wastewater utility systems. The City of Houston's Utility is one of the top ten public water and wastewater utilities within the United States. As Interim Deputy Director, he manages a staff of 1,723 with an annual capital and operations and maintenance budget of over $500 million. Mr. Chang has 20 years of Civil Engineering experience with the City of Houston. Prior to assuming his present duties, Mr. Chang managed and directed a variety of engineering activities and personnel to identify, evaluate, manage and rehabilitate various facilities and systems. Mr. Chang received his B.S. and M.S. degree in Civil Engineering from the University of Houston. He is a Registered Professional Engineer in the State of Texas and is affiliated with the American Society of Civil Engineers, American Water Works Association, Houston Area Water Corporation, Coastal Water Authority, Region H Water Planning Group, American Public Works Association, Water Environmental Federation, Design-Build Institute of America, Texas Water Conservation Association, and the Association of Metropolitan Water Agencies.

Susan Bandy, Deputy Director – Resource Management, assumed her position in May 2005 and has over 20 years of public and private sector experience in accounting, finance and management, 14 years of which have been with the City. Ms. Bandy is currently responsible for the management, monitoring and control of the Department's finances, accounting, IT functions, procurement and warehousing, human resources, and all utility customer services functions. Prior to joining the staff of the Department, Ms. Bandy served as Deputy City Controller over Financial Reporting, Assistant Director (and various other positions) in the City Department of Finance, and was on loan for four years as President of Houston's 2012 Olympic bid effort. Prior to her employment with the City, Ms. Bandy assisted in developing and running the Houston Small Business Development Center, was an accounting lecturer at the University of Houston and worked for two big eight accounting firms. Ms. Bandy has both a Bachelor of Business Administration in Accounting and a Masters of Business Administration from the University of Houston and is a Certified Public Accountant.

Schedule 3 — Employees

The number of System full time-equivalent employees at the end of each of the last four Fiscal Years (2005-2008) and the estimated figure for Fiscal Year 2009 are as follows:

Fiscal Year	Employees
2005	2,220[(1)]
2006	2,158[(1)]
2007	2,121[(1)]
2008	2,154[(1)]
2009 (estimate)	2,149[(2)]

(1) As reported in the Statistical Section of the City of Houston Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008.

(2) Unaudited information as reported in the City's Monthly Financial and Operations Report dated as of January 31, 2009.

The Texas Legislature enacted Chapter 146 of the Local Government Code ("Chapter 146"), which extended to municipal employees of the City, other than department heads, firefighters and police officers, the right to appoint bargaining agents to "meet and confer" with representatives of the City of any agency, board, commission or political subdivision that is required to establish wages, salaries, rates of pay, hours, working conditions or other terms and conditions of employment regarding such issues. Chapter 146 prohibits municipal employees from engaging in strikes and specifically prohibits the bargaining agent and the City from entering into agreements regarding pension-related matters governed by Article 6243g, Vernon's Texas Civil Statutes, or a successor statute (now Article 6243h, Vernon's Texas Civil Statutes). See "EMPLOYEE PENSION FUNDS." However, any agreement affecting the salaries of municipal employees will likely have an effect on the City's pension liabilities.

In order to invoke the provisions of Chapter 146, a majority of the municipal employees must submit a petition requesting the recognition of a particular employee association as the sole and exclusive bargaining agent for all covered employees before the City may begin negotiations with the employee association. After receiving such a petition, the City may (i) grant recognition of the association as requested in the petition and meet and confer under Chapter 146 without an election by the voters of the City, (ii) order an election to determine whether the City may meet and confer under Chapter 146, or (iii) order a certification election to determine whether the employee association represents a majority of the covered employees. See also "—Health Care Benefits for Retired Employees."

The City has recognized the Houston Organization of Public Employees (HOPE) as the exclusive bargaining agent for all covered employees. The City and HOPE have recently entered into a meet and confer agreement with a three-year term ending June 30, 2011, which provides for, among other things, annual across the board wage increases of 3% of base pay and annual performance pay pools of 1.25% of each City department's aggregate base pay. While pension benefits and contributions are not part of the meet and confer agreement, the increase in wages agreed to will affect the City's pension contributions. The City has recently reached an agreement with the Houston Municipal Employees Pension Board ("HMEPS") specifically related to pension benefits and contributions. See also the section captioned "EMPLOYEE PENSION FUNDS" for a discussion of this agreement and the "meet and confer" process for HMEPS.

The City offers its employees, including System employees, an employee benefit package that includes medical, dental and life insurance programs. The City's portion of medical plan expenses increased by approximately 5.9% from Fiscal Year 2007 to Fiscal Year 2008, is expected to increase by 12.3% from Fiscal Year 2008 to Fiscal Year 2009, and is expected to continue to increase based on trends and enrollment fluctuations for the term of the City's latest contract, which started in May 1, 2006. The contract has a three-year term, with two one-year renewal options. The City has engaged a health insurance consultant to recommend ways to control the growth of medical costs. See also the section captioned "EMPLOYEE PENSION FUNDS."

Health Care Benefits for Retired Employees

The City provides certain health care benefits for its retired employees, their spouses and survivors. Employees on long-term disability and their spouses can also qualify for retiree health care benefits. Currently, substantially all of the City's employees that reach normal retirement age while working for the City will become eligible for such benefits. Beginning with the Fiscal Year that commenced on July 1, 2007, the City is required by the Government Accounting Standards Board Statement No. 45 ("GASB 45"), *Accounting by Employers for Other Postemployment Benefits (OPEB)*, to report an actuarially determined cost of post-employment benefits, other than pensions, such as health and life insurance for current and future retirees. Under GASB 45 the City recognizes such costs over the working lifetime of employees, and to the extent such costs are not prefunded, reports such costs as a financial statement liability.

The City has taken steps to assess the current and future financial impact of its unfunded OPEB liabilities, and is reviewing the appropriate policies to address and manage any such liabilities. In preparation for the implementation of GASB 45, the City commissioned a preliminary actuarial study for use as a planning tool in order to assist the City in estimating the actuarial costs of other post-employment benefits and formulating a GASB 45 implementation plan. The preliminary actuarial study indicated that as of June 30, 2006 the City's total actuarial accrued liability (AAL) for benefits earned by the City's municipal employees and classified police officers and firefighters was approximately $3.2 billion, and the annually required contribution needed to pay the normal costs of the benefits and to effect a level amortization of the AAL over a 30 year period would have been approximately $326 million. On July 1, 2008, the City commissioned a new actuarial study, however, the City does not expect the final numbers to be available until May 2009.

Similar to many issuers, the City's prior practice had been to fund the cost of OPEB on an annual pay-as-you-go basis and to account for OPEB costs as a current operating expense in the Fiscal Year in which the OPEB cost is paid. The General Fund paid approximately $44.8 million for retiree health insurance premiums in Fiscal Year 2007. The Combined Utility System enterprise fund paid approximately $6.8 million for retiree health insurance premiums in Fiscal Year 2007 or 12.3% of the City's total payments of $55.2 million. To date, the City has not accumulated assets to offset future benefit costs.

Options available to any issuer such as the City to offset or reduce the future costs of the OPEB liability reported under GASB 45 include the following:

- Reduction of benefits for active employees and/or retirees;
- Increase of required contributions from active employees and/or retirees; and
- Contributing assets or pre-funding with real property, a dedicated revenue stream or other taxes or City assets not yet identified.

See also Note 11 of the City's audited financial statements for Fiscal Year 2008, presented in APPENDIX A, which includes information relating to retiree health care premiums paid by the City in Fiscal Year 2008, as well as information relating to health and long-term disability benefits.

Budget for the System

Each year, under the provisions of Texas law and the City Charter, the Mayor prepares and submits to City Council a City Budget for the System. City Council may amend the proposed budget prior to its approval and adoption. If a budget is not adopted prior to the beginning of a Fiscal Year, City Council is authorized by the City Charter to adopt a continuing appropriations ordinance in order to fund the operations of City government until City Council has approved and adopted a budget for the Fiscal Year. The Fiscal Year 2009 Budget was adopted by City Council on June 18, 2008, and assumes an automatic water and sewer rate increase taking effect as of April 2008. See "SECURITY FOR THE SERIES 2009A BONDS — Automatic Annual Rate Adjustments" and "RATES."

Schedule 4 —System Budget (Fiscal Year 2009)

The following is a summary of the adopted budget for Fiscal Year 2009 and the adopted budget for Fiscal Year 2008.

RESOURCES	FY09 in thousands	FY08 in thousands
Beginning Fund Balance, July 1[(1)]	$ 283,371	$ 315,335
Current Revenues	776,668	738,988
TOTAL RESOURCES	$ 1,060,039	$ 1,054,323
EXPENDITURES		
Maintenance and Operation	$ 352,602	$ 343,405
CWA and TRA Debt Service[(2)]	28,103	32,642
HAWC Debt Service	-	-
Debt Service - Bonds	313,077	287,058
Discretionary Debt Transfer	28,419	30,452
Equipment Replacement	23,965	19,420
Transfers for Drainage	39,437	38,395
TOTAL EXPENDITURES	786,246	751,372
Planned Ending Balance	273,794	302,951
TOTAL EXPENDITURES & RESERVES	$ 1,060,039	$ 1,054,323

(1) Unaudited information as reported in the City's Fiscal Year 2008 Adopted Operating Budget and Fiscal Year 2009 Adopted Operating Budget.

(2) See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

City Investment Policy

The City maintains an investment strategy that emphasizes, in order of priority, safety, liquidity and return on investment, as embodied in its investment policy (the "Policy"). The City does not invest in inverse floaters, or interest-only or principal-only mortgage-backed securities. The Policy provides, among other things, that (1) the Investment Manager (as defined in the Policy) shall submit quarterly investment reports to City Council and (2) the Policy shall be reviewed annually by City Council. For a further discussion of the City's investments as of June 30, 2008, see Note 1.E.1 and Note 3.B of the Notes to the Financial Statements for Fiscal Year 2008 as set forth in APPENDIX A. On November 5, 2008, the City Council amended the Investment Policy to, among other things, allow the City to purchase its own general obligations or enterprise-issued obligations on a temporary basis.

Standard & Poor's Rating Services ("S&P") has assigned an "AAAf" credit quality rating, and an "S1" volatility rating to the City's General Investment Portfolio. The ratings reflect the view of S&P, from whom an explanation of the significance of such ratings may be obtained.

Interest Rate Swap Policy

On November 25, 2003, the City adopted a master swap policy (the "Swap Policy"), to provide guidance for the City in its use of swaps, caps, floors, collars, options and other derivative financial products (collectively, "Swaps") in conjunction with the City's management of its assets and liabilities. The Swap Policy describes the circumstances and methods by which Swaps will be used, the guidelines to be employed when Swaps are used, and who is responsible for carrying out these policies. The City may enter into Swaps as authorized by the City Council and approved by the Attorney General of the State of Texas in connection with the issuance or payment of certain debt obligations, before, concurrently with, or after the actual issuance of the debt.

As a general rule, the City will enter into transactions only with counterparties whose obligations are rated in the double-A category or better from at least one nationally recognized rating agency. In addition, if a counterparty's credit rating is downgraded below the double-A rating category, the City may require that its exposure to the counterparty be collateralized or may exercise its right to terminate the transaction prior to its scheduled termination date. In order to limit the City's counterparty risk, the City will seek to avoid excessive concentration of exposure to a single counterparty or guarantor.

The Swap Policy provides that the City may choose counterparties for entering into Swap contracts on either a negotiated or competitive basis. To provide safeguards on negotiated transactions, the Swap Policy provides that the City may secure outside professional advice to assist in the process of structuring, documenting and pricing the transaction, and to verify that a fair price was obtained. In any negotiated transactions, the counterparty will be required to disclose all payments to third parties (including lobbyists, consultants and attorneys) who had any involvement in assisting the counterparty in doing business with the City.

The City will track and regularly report on the financial implications of its Swaps. A quarterly report will be prepared for the City Council including: (i) a summary of key terms of the agreements, including notional amounts, interest rates, maturity and method of procurement, including any changes to Swap agreements since the last reporting period; (ii) the mark-to-market value (termination value) of its Swaps, as measured by the economic cost or benefit of terminating outstanding contracts at specified intervals; (iii) the amount of exposure that the City has to each specific counterparty, as measured by aggregate mark-to-market value, netted for offsetting transactions; (iv) the credit ratings of each counterparty (or guarantor, if applicable) and any changes in the credit rating since the last reporting period; and (v) any collateral posting as a result of Swap agreement requirements. In addition, the City will perform such monitoring and reporting as is required by the rating agencies or for compliance with GASB requirements.

Water Facilities

General. The Water Facilities provide treated and untreated water in a service area that includes the City and certain municipalities and unincorporated communities in the Houston metropolitan area. Some of the City's largest wholesale customers are other cities and water authorities which supply water to their own customers. See "SOURCES OF SYSTEM REVENUES — Schedule 6 — Ten Largest Treated Water Customers" and "— Schedule 7 — Ten Largest Untreated Water Customers." The System has acquired sources of surface water at Lake Houston and Lake Conroe in the San Jacinto River System and Lake Livingston, Wallisville Saltwater barrier and senior water rights in the Trinity River System which, when aggregated with present and anticipated groundwater supplies, are expected to be sufficient to meet the anticipated demands of the Water Facilities' customers through the year 2035. System surface water is transported into the Houston metropolitan area by the West Canal (San Jacinto System) and the CWA Conveyance System (Trinity River System), and is either treated and introduced into the System's treated water distribution system or sold as untreated or raw water. Except for amounts consumed by the City, all groundwater (after chlorination) and a portion of surface water (after treatment and disinfection) is distributed throughout the Houston metropolitan area for sale to domestic, commercial, industrial and agricultural customers.

The Water Facilities consist of treated and untreated water distribution and transmission lines, surface water treatment plants and pump stations, groundwater wells and pump facilities and ground and elevated storage tanks. The Water Facilities are operated in compliance with requirements of Texas law related to public water supply systems.

Water Supply Contracts. Under a 1968 agreement (as amended and superseded in part) and a 1995 agreement (as supplemented) Coastal Water Authority ("CWA") agreed to construct the CWA conveyance system and certain other projects, and the City agreed to pay, as a Maintenance and Operation expense of the Water and Sewer System, amounts calculated to be sufficient to cover Maintenance and Operation expenses of the CWA conveyance system, plus debt service on the bonds issued by CWA. CWA has reserved the right to issue an unlimited amount of additional bonds on a parity with those currently outstanding; however, such issuances are subject to the approval of the City. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

CWA and the City have entered into a contract for a surface water project at Luce Bayou, and CWA has issued $28 million in contract revenue bonds to pay for the design of the project and right of way acquisition.

Approximately 35% of project costs will be paid by the Central Harris County Regional Water Authority, North Harris County Regional Water Authority, West Harris County Regional Water Authority, and North Fort Bend Regional Water Authority. Additional borrowing will be required for actual construction. The City's contribution to such project will come from the CUS General Purpose Fund. See "SYSTEM CAPITAL IMPROVEMENT PLAN – CUS General Purpose Fund."

Under a 1964 agreement (as supplemented), the City and Trinity River Authority ("TRA") agreed to construct Lake Livingston, and the City agreed to pay, as a Maintenance and Operation expense of the Water and Sewer System, amounts calculated to be sufficient to cover the Maintenance and Operation expenses of the Lake Livingston project, less recoupment of a maximum of 30% of such costs. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

For information relating to certain surface water conversion measures being undertaken by the City and other local entities to comply with requirements of the Subsidence District (defined below), see "EFFECTS OF SUBSIDENCE."

Schedule 5 — Water Supply — Capacity, Production and Sales

The following schedule sets forth information concerning the Water Facilities' capacity, production and sales for Fiscal Year 2008 (million gallons per day):

Million Gallons Per Day (mgd)

	Permitted Available Yield	System Capacity	Average Daily Production	Sales
Ground	72.0	300.0	55.0	N/A
Surface	1,090.0	1,202.0	544.0	N/A
TOTAL	1,162.0	1,502.0	599.8	570.0
Treated				330.0
Untreated				240.0
TOTAL				570.0

Regional Planning. Legislation enacted by the Texas Legislature in 1997 (the "1997 Act") requires regional water planning for the State of Texas. The TWDB has designated 16 regional water planning areas. The regional plans for all 16 areas, including the Houston Area referred to as Region H, have been submitted to the Texas Water Development Board as required by the legislation. The TWDB has combined all of the regional plans into a State Water Plan.

The 1997 Act, as amended in 1999, not only required regional planning, but also revised the law related to inter-basin water transfers, water marketing, water-related data collection and dissemination and TWDB loan assistance funds. TWDB has adopted state and regional water planning rules. The rules provide broad guidance on how the regional water planning groups will develop a regional water plan for their area, how approved regional water plans will be incorporated into the State Water Plan and how to apply for funding for regional water plan development. Each area's regional water planning group was required to submit a regional water plan to the TWDB by January 2001. TWDB adopted the 2002 State Water Plan in December 2001. Financial assistance may be provided only to projects that meet needs in a manner consistent with the approved regional water plans and are included in the State Water Plan. Further, it is expected that additional costs, which may be significant, will be necessary to meet the changes in surface water rights permitting and regional water planning. The Drinking Water State Revolving Fund, which is directed at systems that are not in compliance with Safe Drinking Water Standards, may eventually provide some assistance for City projects but, because of limited funds, projects are currently being funded on a priority basis.

The City has also contracted to purchase Dayton Canal water rights in the Trinity River. The permitting relating to this project was obtained in 2005.

Condition of the Water Facilities. Many of the Water Facilities have been constructed or reconstructed during the last 30 years. The cost of repairs and expenditures for renewal, refurbishing and replacement of such Water Facilities increases as they wear out or become obsolete. Total System production capacity is currently adequate to meet projected near-term peak demands. See "SYSTEM CAPITAL IMPROVEMENT PLAN — Capital Improvement Plan."

Water Quality. Treated water provided by the Water Facilities is subject to extensive federal and state laws and regulations. The City currently meets or surpasses all federal and state established water quality standards, and its water system has been designated as a "Superior Water System" by the State of Texas. The 1996 amendments to the federal Safe Drinking Water Act redirected the approach of the Environmental Protection Agency (the "EPA") to regulation, and has resulted in the EPA's adoption of a series of rules relating to disinfectants/disinfection byproducts in drinking water and certain specific contaminants posing health risks, such as arsenic, with which the City must now comply. There is, however, one rule proposed by EPA and relating to radon in drinking water (the "Radon Rule"), which the City anticipates may result in the incurrence of significant capital costs to comply with, should the rule be adopted in its current form.

The Radon Rule was proposed on November 2, 1999. The EPA proposed a Maximum Contaminant Level for Radon at 300 picocuries/liter. An Alternative Maximum Contaminant Level ("AMCL") was proposed at 4000 picocuries/liter, which would be available if a state adopts a statewide Radon Multi-Media Mitigation Program ("MMMP"). Water systems have the option to develop their own regional MMMP, approvable by EPA, if the state in which the system in located does not implement a statewide program. This rule could affect up to 80 groundwater treatment plants. If the MCL of 300 picocuries/liter must be met, capital costs for System compliance would be approximately $11,000,000. If an EPA approvable MMMP is in place, and the AMCL requirement must be met, capital costs for System compliance would be approximately $300,000. A firm date for implementation of the Radon Rule has not yet been established by EPA.

In addition, pursuant to the 1996 amendments of the federal Safe Drinking Water Act, all community water systems are required to prepare and mail to each system customer a report, known as a "Consumer Confidence Report," that provides information about the system's source water and the level of contaminants in the drinking water supplied to the customer. The City is required to develop and mail these Consumer Confidence Reports to customers on an annual basis and has been doing so for several years. To date, the costs incurred by the City in connection with obtaining drinking water data and preparing and distributing the reports have not been significant.

Sewer Facilities

General. The Sewer Facilities receive and process wastewater generated in a service area that includes the City and certain municipalities and unincorporated communities in the Houston metropolitan area. The Sewer Facilities consist of sanitary sewer lines, permitted wastewater treatment plants, sludge treatment facilities, pumping stations and a centralized laboratory. The general condition of the collection lines of the Sewer Facilities varies depending on age, location and type of construction. The average daily wastewater flow through the Sewer Facilities for Fiscal Year 2008 was 267.98 mgd. The effective treatment capacity of the Sewer Facilities, as reflected by State permits, was 563.1 mgd as of June 30, 2008.

In general, the City addresses growth in demand for sewer services by evaluating the Sewer Facilities' ability to transport and treat the additional wastewater expected upon completion of any proposed new construction before granting a building permit for construction. Through this program, prospective users are granted or denied building permits on the basis of the Sewer Facilities' capacity to handle such additional demands.

In addition to addressing growth in demand for sewer services in the City, the Sewer Facilities' Capital Improvement Plan now includes the regional coordination of sewer facilities to be provided by utility districts in those unincorporated areas which are within the extraterritorial jurisdiction of the City and potentially subject to future annexations. See "ANNEXATION PROGRAM AND 'IN-CITY' DISTRICTS." To implement this policy of regionalization, the City conditions its consent to the formation of utility districts upon such City's conformance with the City's overall System development plans. In those instances where an existing or proposed utility districts is in close proximity to an existing or proposed Sewer Facilities treatment plant, the City encourages the utility district to contract with the City for wholesale treatment services under an arrangement where the utility district contributes to the capital cost of the treatment facility, as determined on a System-wide basis. See "RATES —

Ratemaking" and "— Schedule 9— Rate Adjustments." Through this approach, the City intends to (i) discourage further development of incompatible or inadequate facilities that must be modified or abandoned when the utility district is annexed and (ii) gain participation by certain districts in Sewer Facilities costs.

Federal and State Regulation of the Sewer Facilities. The operations of the Sewer Facilities are subject to regulation under the federal Clean Water Act and the Texas Water Code. All discharges of pollutants into the nation's navigable waters must comply with the Clean Water Act. The Clean Water Act allows municipal wastewater treatment plants to discharge treated effluent to the extent allowed in permits issued by the EPA pursuant to the National Pollutant Discharge Elimination System ("NPDES") program, a national program established by the Clean Water Act for issuing, monitoring and enforcing wastewater discharge permits. In 1998 the EPA delegated the NPDES program to the State of Texas, resulting in the establishment of the Texas Pollutant Discharge Permit Elimination System ("TPDES") program in lieu of the NPDES program.

TPDES permits set limits on the type and quantity of discharge, in accordance with state and federal laws and regulations. The Clean Water Act requires municipal wastewater treatment plants to meet secondary treatment effluent limitations (as defined in EPA regulations). The Clean Water Act also requires that municipal wastewater treatment plants meet any effluent limitations established by state or federal laws or regulations which are more stringent than secondary treatment. Under the Clean Water Act, states must identify any body of water for which more stringent effluent standards are needed to achieve national water quality standards. For each body of water, the state is required to establish the maximum allowable daily load of certain pollutants identified by the EPA. The Texas Commission on Environmental Quality ("TCEQ") has been conducting evaluations of water quality of the streams and other waterbodies into which the City discharges wastewater, and TCEQ has established maximum allowable daily loads for certain pollutants in streams and waterbodies that do not meet applicable water quality standards. In certain instances the City is required to perform additional treatment of wastewater in order to comply with the load limit established by TCEQ. The Clean Water Act allows municipalities to apply for extensions of applicable deadlines for additional treatment in certain circumstances.

Potential Penalties for the System's Violations. The failure by the City to achieve compliance with the Clean Water Act could result in either a private plaintiff or the EPA instituting a civil action for injunctive relief and civil penalties of up to $37,500 per day per violation. In addition, the EPA has the power to issue administrative orders, and impose administrative penalties (of up to $16,000 per day per violations), to compel compliance with its regulations and the applicable permits. The EPA can also bring criminal actions seeking to impose fines of up to $25,000 per day per violation for negligent violations and up to $50,000 per day per violation for knowing violations of permit conditions or discharge without a permit. Violations of permits or administrative orders may result in the inability of a municipality to obtain federal assistance pursuant to the Clean Water Act in financing its capital improvements.

Under State law, civil penalties for violation of State wastewater discharge permits or orders are a maximum of $25,000 per day per violation. The Executive Director of the TCEQ also has authority to levy administrative penalties of up to $10,000 per day per violation for noncompliance with the rules, orders or permits issued by the TCEQ. Such administrative penalties are subject to judicial review. An injunctive order resulting from a civil action could require the imposition of additional user or service charges or the issuance of additional bonds to finance the improvements required to ameliorate a condition that may have caused the violation of a TCEQ permit. The City has been the subject of such administrative penalties in the past. In addition to administrative and civil penalties, TCEQ may also impose criminal penalties for violations of State wastewater discharge permits or orders.

EFFECTS OF SUBSIDENCE

General

Harris County, the county in which the City is principally located, and Galveston County have experienced substantial subsidence of the ground. This subsidence is largely the result of extensive withdrawals of groundwater by industries, municipalities and other entities that own and operate water wells. The Harris-Galveston Coastal Subsidence District (the "Subsidence District"), established by the Texas Legislature in 1977, provides regulatory control over the withdrawal of groundwater in Harris County and Galveston County in an effort to limit land surface subsidence in these counties.

Subsidence District Plans

On April 14, 1999, the Subsidence District adopted a comprehensive plan (the "1999 District Plan") for the reduction of groundwater use for subsidence abatement. This plan divides the Subsidence District into three (3) regulatory areas. The boundaries of Area 1 remain the same as the boundaries of Area 1 in the City plan adopted in 1992 (the "1992 District Plan"). Area 1 covers most of Galveston County and an area in southeast Harris County that includes a small part of the City. The restrictions on groundwater use in Area 1 remain at 10% of the total annual groundwater and surface water use of each well permit holder. Area 2 in the 1999 District Plan combines former Areas 2 and 3 in the 1992 District Plan. Area 2 includes a small part of west Galveston County, about one third of Harris County and nearly one half of the City. The restrictions on groundwater use in Area 2 remain at 20% of the well permittees' total annual groundwater and surface water use. The new Area 3 includes the remainder of Harris County (Areas 4, 5, 6, and 7 in the 1992 District Plan). Beginning in January 2003, all well permit holders that had not reduced their groundwater use to the ultimate goals for their area (10% in Area 1 and 20% in Areas 2 and 3) were required to submit a Groundwater Reduction Plan ("GRP") to the Subsidence District for certification. The 1999 District Plan required a GRP for each well permit holder in Area 3 in 2003 and requires conversion to 30% surface water by 2010, 70% surface water by 2020 and 80% surface water by 2030. Two or more well permit holders may join together by contract in an effort to jointly meet the Subsidence District's requirements by using the pumping credits of one permit holder to offset the conversion deficiencies of another permit holder.

The City is currently in compliance with the 1999 District Plan. In October 2002, the Subsidence District approved the City's GRP that included provisions to meet required reduction in groundwater use in Area 3. Since the City holds the majority of the surface rights available to the Houston Region, it is anticipated that many of the well permit holders outside the City (municipal utility districts, commercial and industrial users, etc.) will join the City in developing a GRP that includes their respective areas. To that end, the City has over 90 executed GRP contracts.

The long-term objective of the City, in compliance with the 1992 and 1999 District Plans, is to change the Houston area's water supply sources from predominantly groundwater to predominantly surface water. In addition to the cost of constructing additional surface water facilities, the City anticipates that the cost of operating such facilities will be greater than that of groundwater facilities. Accordingly, as the System utilizes more surface water, the operating costs of the System will increase. The increased costs reflect the additional costs of electrical power for the System's water treatment plants and chemicals used for treatment. In addition to these costs, the operating costs of the System may also increase as the result of more stringent treatment requirements for drinking water and water supply systems imposed by federal and State regulatory authorities. Such is the case with respect to the recent review of the federal standard for arsenic content in drinking water. For further information, see "THE CITY AND THE SYSTEM—Water Facilities— Water Quality".

Subsidence District regulations that require conversion to surface water can be costly to industries, municipalities and other groundwater well operators since the process of converting from a groundwater supply to a surface water supply can result in substantial capital expenditures. Additionally, the per unit cost of supplying surface water is substantially higher due to the cost of treatment. As the major holder of surface water rights in the area, the City has been cooperating with industries, municipalities and others to provide surface water through several different financial arrangements. In this regard, the City has entered into capital cost sharing agreements with certain other cities, water authorities, water districts and a federal government joint venture and has entered into or is in the process of negotiating various water supply contracts to provide treated surface water to municipalities, water authorities and water districts in the region. As part of this effort, the City has made or caused to be made various improvements to its water purification plants in order to add additional surface water capacity to the region. Set forth below is a more detailed description of certain surface water conversion measures being undertaken by the City and other local entities to comply with the Subsidence District requirements.

Southeast Water Purification Plant

The City has entered into a capital cost sharing agreement with ten participants in connection with the City's Southeast Water Purification Plant ("SEWPP"). Pursuant to this agreement, the participants have made payments toward the construction of the SEWPP and have agreed to pay proportional shares of operation and maintenance costs of the plant, based on quantity of water used. The City and the participants have developed the SEWPP with a total capacity of 120 mgd. In addition, a design and construction contract has been approved by City

Council that will increase the capacity by another 80 mgd in 2010. Approximately 50% of such increased capacity will be for City use. The construction will be financed from water and sewer revenue bonds issued by the City. Future payments by the participants for such increased capacity will be made to the City pursuant to the cost sharing agreement.

Houston Area Water Corporation and Northeast Water Purification Plant

Houston Area Water Corporation ("HAWC") coordinates and manages the Northeast Water Purification Plant ("NEWPP"), which is a part of the City's plan to meet subsidence requirements through the establishment of a regional water distribution system to serve the City and other willing customers in Area 3. The NEWPP consists of a 80 mgd surface water treatment plant, along with a water conveyance system, that processes untreated water delivered by the City pursuant to an untreated water contract between the City and HAWC. The City has also entered into a contract with the HAWC to purchase all of the treated water produced by the NEWPP. The City took over operation of the NEWPP in 2008.

North Harris County Regional Water Authority

The North Harris County Regional Water Authority (the "NHCRWA") was approved by voters as a separate governmental subdivision at an election held in January 2000 in an effort to meet the requirements of the Subsidence District. In December 2002, the City entered into a water supply contract with the NHCRWA to provide 31 mgd to service approximately 400,000 residents in the unincorporated areas of Harris County. In Fiscal Year 2004, the NHCRWA made a $51.5 million payment to the City in connection with the treated surface water to be provided by the City.

West Harris County Regional Water Authority

The West Harris County Regional Water Authority (the "WHCRWA") was authorized as a separate governmental subdivision by the Texas Legislature in 2001 to help coordinate efforts by municipalities and water districts in west Harris County to comply with Subsidence District requirements. In April 2003, WHCRWA entered into a water supply contract with the City for the purchase of 28.25 mgd of treated surface water from the City to meet the requirements of the Subsidence District. A number of water districts that petitioned to opt out of the WHCRWA have negotiated a separate contract to purchase treated water from the City. In Fiscal Year 2004, the WHCRWA made an $81 million payment to the City in connection with the treated surface water to be provided by the City.

North Fort Bend Water Authority

The North Fort Bend Water Authority (the "NFBWA") was authorized as a separate governmental subdivision by the Texas Legislature in 2005 to help coordinate efforts by municipalities and water districts in northern Fort Bend County to comply with Fort Bend Subsidence District requirements. In July 2008, the NFBWA entered into a water supply contract with the City for the purchase of 19.5 mgd of treated surface water from the City to meet the requirements of the Fort Bend Subsidence District. In January 2009, the NFBWA entered into a first supplement to the water supply contract with the City that provides for the construction, financing, and cost sharing of an interbasin water transfer project known as "Luce Bayou." In Fiscal Year 2009, the NFBWA made a $2,205,631 interest payment and another $27,315 payment to the City in connection with the treated surface water to be provided by the City.

Central Harris County Water Users Consortium

The Central Harris County Water Users Consortium (the "Consortium") is an association consisting of: Harris County Municipal Utility District No. 33, Harris County Municipal Utility District No. 150, Harris County Municipal Utility District No. 200, Harris County Municipal Utility District No. 205, Harris County Municipal Utility District No. 215, Harris County Municipal Utility District No. 217, Harris County Municipal Utility District No. 304, Harris County Utility District No. 16, Fallbrook Utility District and Rankin Road West Municipal Utility District. The Consortium was created pursuant to an Agreement dated December 13, 2002, for the purpose of collectively satisfying the requirements of the 1999 Plan, as amended. In 2002, the Consortium entered into a water supply contract with the City for the purchase of treated surface water from the City for distribution and use by

members of the Consortium for domestic, commercial and other purposes. The Consortium may, but is not obligated to, purchase water from the City in order to satisfy the Consortium's year 2020 and year 2030 Harris Galveston Coastal Subsidence District conversion requirements.

ANNEXATION PROGRAM AND "IN-CITY" DISTRICTS

Annexation Program

General. Chapter 42, Texas Local Government Code, as amended, provides that, within the limits described therein, the unincorporated area contiguous to the corporate limits of any city constitutes that city's extraterritorial jurisdiction. The extent of a city's extraterritorial jurisdiction depends in part on the city's population. For the City, the extraterritorial jurisdiction consists of all the contiguous unincorporated areas, not a part of any other city, within five miles of the corporate limits of the City. With certain exceptions, a city may annex territory only within the confines of its extraterritorial jurisdiction. When a city annexes additional territory, the city's extraterritorial jurisdiction expands in conformity with such annexation. Under Chapter 43, Texas Local Government Code, as amended, when a city annexes additional territory, the city's extraterritorial jurisdiction expands in conformity with such annexation; however, since 1999, there are significant additional procedures and requirements governing annexation, including the requirement that the City adopt a three year annexation plan, discussed below, as well a service plan for each area to be annexed. Each service plan must include certain municipal services as well as the construction or acquisition of any needed capital improvements by certain dates. A failure by the City to provide the required services or improvements for a particular area on a timely basis may result in a petition for disannexation of the area and its subsequent disannexation. The sections that follow discuss water districts, full purpose annexations (the method prior to 1999 by which the City historically expanded its boundaries) and limited purpose annexations and strategic partnerships (which have resulted from the 1999 changes in Texas law).

Water districts. Water districts are political subdivisions of the State of Texas empowered to issue bonds and to own and operate water, sanitary sewer and drainage systems. Water district bonds are usually payable from the receipts of ad valorem taxes levied by the water district and, in some cases, are further payable from the net revenues, if any, derived from the operation of its water and sanitary sewer systems.

Full Purpose Annexations. Historically, the City expanded its geographic boundaries and tax base through the full purpose annexation of contiguous unincorporated areas. These annexations included properties served by a large number of water districts. However, as previously noted, in 1999 full purpose annexations became procedurally more difficult to undertake and as a result are not frequent. Since 1999, the City has completed only one full-purpose annexation limited to road rights-of-way.

For water districts subject to full purpose annexation by the City, State law generally requires that the City (i) take over all assets of the water district, (ii) assume all debts, liabilities and obligations of the water district, (iii) perform all functions and services of the water district, and (iv) provide full City services to the annexed area. State law also requires that the City assume the water district's functions within 90 days following the annexation. When the City assumes water district bonds or other obligations payable in whole or in part from ad valorem taxes, State law requires the City to levy and collect ad valorem taxes on all taxable property within the City in amounts sufficient to pay the principal of and interest on such assumed bonds and obligations. The City may issue voter-authorized but unissued bonds of annexed water districts, but the proceeds must be used for the voted purposes within the annexed water district. Under existing law, neither the annexation of water districts nor the assumption of their outstanding bonds or other obligations requires voter authorization.

Limited Purpose Annexations and Strategic Partnership Agreements. Since the change in Texas law described above, the City is required to adopt a three-year annexation plan and, with certain exceptions, only those areas identified in such plan are eligible for annexation. The City has adopted three-year plans every December since 1999. Those plans do not identify any territory for annexation, and the City currently has no plans to annex additional territory. If the City were to decide to annex territory during the three year period of the plan, such annexation generally would be of territory that is not required to be identified in the plan or territory annexed as the result of an agreement between the City and either property owner or a water district board. The primary exceptions to that requirement would be small tracts of land.

A water district included in an annexation plan may, by written request, require the City to negotiate and enter into a strategic partnership agreement, which may delay or serve as an alternative to annexation of the City. A strategic partnership agreement must be of benefit to both parties. Should the City and any such district be unable to reach an agreement on the terms of the strategic partnership agreement, either party may seek binding arbitration. During the pendency of the arbitration proceeding or during the appeal of an arbitration decision, the City may not annex the district. Texas law also gives the City the option of entering into strategic partnership agreements with municipal utility districts by mutual consent without proposing the annexation of the district.

Strategic partnership agreements may provide for limited-purpose annexation for a period of time, during which the City may impose a sales and use tax within the boundaries of the part of the District that is annexed for limited purposes. Strategic partnership agreements may provide that at the completion of the agreed duration of the limited purpose annexation, full-purpose annexation may occur either on an agreed full-purpose annexation date without the need for further action by the City, or by City action at that time. The qualified voters of an area annexed for limited purposes are entitled to vote in municipal elections for members of the governing body or for amendments to the municipal charter. Such voters may not vote in a bond election.

The City has completed 185 limited-purpose annexations by mutual consent with approximately 161 of the water districts in the City's extraterritorial jurisdiction, all of which continue to exist. The City expects to enter into similar agreements with other Districts in the future. Generally, the limited-purpose annexations have applied only to non-residential property, and the City is authorized to, and does impose, its sales tax in each of the areas annexed for limited purposes. In most cases the City and a district divide the sales tax evenly. The City is not authorized to levy an ad valorem tax on property annexed for limited purposes, and the district continues to levy and collect ad valorem taxes. The strategic partnership agreements entered into so far by the City defer the time for full-purpose annexation by City action for periods of up to 30 years or, in some cases, until the district utility system is developed or some other event occurs.

The City does not assume the debts of a district until such time as the district is annexed for full purposes, at which time all of the sales taxes collected within the City will be retained by the City, the annexed area will become subject to City ad valorem tax levy and collection, the district will be dissolved and the debt will be assumed by the City. In some cases, the City agrees to provide police or health inspection services to the district, if the cost of providing such services is marginal to the City. Generally, in two cases where land was disannexed by the City and reannexed for limited purposes, the City agrees to provide fire, police and emergency medical services to the district.

The State legislature passed Senate Bill 1012 in 2007, which authorizes the City and certain large unincorporated areas within the City's extraterritorial jurisdiction to establish regional participation agreements. Senate Bill 1012 allows for the implementation of a plan announced by the City and The Woodlands in January 2007 that would allow the residents of The Woodlands to choose their form of self-government and to provide an ongoing financial partnership between The Woodlands and the City for projects. Projects would include funding for mobility, the development and maintenance of major regional parks, and certain improvements making it easier to get in and out of the institutions within the Texas Medical Center used by residents of the entire region, including The Woodlands. The plan would allow the option for a broader source of revenue, specifically, the use of local sales taxes. The bill also provides a mechanism by which the City could agree to defer annexation of The Woodlands for a specific time period or release The Woodlands from its extraterritorial jurisdiction. In November 2007, the voters of The Woodlands approved three ballot propositions necessary for the City and The Woodlands to move forward with the plan.

In-City Districts

Texas law authorizes the creation of certain types of "in-city" districts with independent taxing authority. The City has authorized by ordinance the creation of water districts within its corporate limits, (**six)** of which have been created (one of which, Harris County Municipal Utility District No. 361, was disannexed and then re-annexed for limited purposes pursuant to a strategic partnership agreement) and three additional water districts which have been consented to by the City but not yet created. See "— Limited Purpose Annexations and Strategic Partnership Agreements" above.

In order to encourage development within the City, the City has entered into agreements with "in-city" districts whereby the City will provide the water, wastewater and stormwater drainage infrastructure in the district and convey such facilities to the City, although in some instances, the district has retained ownership and operation of its facilities. In exchange, the City agrees to maintain the facilities and rebate to the district, the portion of district ad valorem taxes collected within the district and attributable to drainage. In some agreements, the City agrees to collect water and wastewater charges at standard City retail rates and remit to the district for deposit in the debt service fund of the district, the difference between City retail rates and wholesale rates. The District's obligations under these agreements are payable only from revenues from within the district, can never exceed annually the annual debt service of the District and expire upon maturity of the district's bonds.

In addition, 14 active municipal management districts created by the Texas Legislature also exist within the corporate limits of the City and have independent authority to impose assessments on certain property owners to support and enhance specific residential or business corridors within the City. Municipal management districts may issue bonds secured by assessments or taxes levied on property within the district pursuant to a vote in such district approving the bonds.

The City has also created certain entities to enhance and encourage redevelopment activities within the City and to provide a mechanism to fund certain public improvements and related redevelopment costs, in addition to providing administrative support for these projects. In many cases, in order to move effectively and efficiently manage the tax increment reinvestment zones, the City has created local government corporations, which are not for profit local government corporations created under Chapter 431 of the Texas Transportation Code, as amended. Such redevelopment authorities are created to aid, assist and act on behalf of the City in the performance of certain of the City's governmental and proprietary functions, including acting as a financing vehicle for the reinvestment zones. Tax increment revenues for each such reinvestment zone are initially deposited in separate tax increment funds maintained by the City and then a local government corporation if a local government corporation has been created to manage such reinvestment zone. Projects financed on behalf of tax increment reinvestment zones are typically accomplished through the issuance of bonds by local government corporations which pledge tax increment revenues received from the City by virtue of a contract between the respective local government corporation, the tax increment reinvestment zone, and the City. The City has also created certain public improvement districts but their existence does not materially impact the operations of the System.

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SOURCES OF SYSTEM REVENUES

General

As of June 30, 2008, the Water Facilities and the Sewer Facilities served approximately 429,821 and 413,418 active service connections, respectively. During Fiscal Year 2008, approximately 46.6% of System Gross Revenues were derived from the sale of water (89% from treated water and 11% from untreated water), approximately 42.7% from providing wastewater treatment services, 3.0% from interest income and the remaining 7.8% from various other sources. Of the treated water sales, 95% of revenues were from retail customers and 5% from bulk sales to other governmental entities.

Water and Sewer Facilities

Schedule 6 — Ten Largest Treated Water Customers

The following schedule presents information concerning the ten largest treated water customers of the System for the twelve month period ended June 30, 2008. The total charges to such customers during such period represent approximately 3.7% of the System Gross Revenues and 8.0% of total water sales revenues for such period.

	Customers	Treated Water Charges
1.	City of Pasadena	$ 4,888,942
2.	North Channel Water Authority	4,624,691
3.	Anheuser-Busch, Inc.	3,274,378
4.	Harris County	2,446,929
5.	Clear Lake City	2,079,676
6.	Houston Independent School District	2,057,444
7.	Valero Refining Co.	2,018,387
8.	City of Houston	1,966,523
9.	City of Pearland	1,859,106
10.	Gulf Coast Water Authority	1,465,433
	TOTAL	$ 26,681,509

Schedule 7 — Ten Largest Untreated Water Customers

The following schedule presents information concerning the ten largest untreated water customers of the System for a twelve month period ending June, 2008. The total of the contract payments by these ten customers during the period represents approximately 3.7% of the System Gross Revenues and 8% of total water sales revenues for such period.

	Customers	Untreated Water Charges
1.	Equistar Chemicals LP*	$ 5,376,386
2.	Shell Oil Company	3,810,362
3.	Houston Area Water Corporation	3,458,590
4.	Battleground Water Company	2,924,922
5.	Air Liquide America Corporation	2,384,458
6.	Houston Refining, LP (Lyondell – Citgo)*	2,254,899
7.	Chevron Phillips Chemical Company, LP	2,229,803
8.	Baytown Area Water Authority	1,809,682
9.	Hoescht Celanese Chemical Group, LTD	1,324,072
10.	Occidental Chemical Corporation	1,048,697
	TOTAL	$ 26,621,871

* On January 6, 2009, Lyondell Chemical Company and certain of their direct and indirect United States subsidiaries, including Equistar Chemicals, LP, filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code (the "Petition"). From the date the Petition is filed, the utility customer's account is governed by applicable bankruptcy laws, which require the customer to furnish adequate assurance of payment for service. The City opens a new account for the customer for all payments post-bankruptcy. The City has established procedures in place for customers who have filed bankruptcy and works to collect all outstanding balances. If amounts are owed pre-petition, the City may apply any existing deposit and is otherwise an unsecured creditor in the bankruptcy proceeding if a proof of claim is properly filed.

Schedule 8 — Ten Largest Sewer Customers

The following schedule presents information concerning the ten largest customers of the Sewer Facilities for the twelve month period ended June 30, 2008. The total charges to such customers represent approximately 3.6% of the System Gross Revenue and 8.5% of Sewer Facilities gross charges during such period.

	Customers	Gross Charges
1.	Anheuser-Busch, Inc.	$ 6,584,102
2.	City of Houston	4,688,520
3.	Harris County	3,162,399
4.	Houston Independent School District	2,629,732
5.	Maximus Coffee Group	2,004,679
6.	Memorial Hermann Hospital	1,810,332
7.	University of Houston	1,660,097
8.	M.D. Anderson Cancer Center	1,205,738
9.	Valero Refining Co	1,027,312
10.	Methodist Hospital	1,013,007
	TOTAL	$ 25,785,918

RATES

Ratemaking

City Council has the authority to establish and increase rates for services provided by the System, subject to certain contractual limitations and subject to the limited regulatory jurisdiction discussed below. In setting water and sewer rates, the City is bound by the legal requirements that such rates must be reasonable, equal and uniform and that no free service may be allowed, except at the discretion of City Council for certain public buildings and facilities. In the event that any such free service would violate the terms of a governmental grant, then the City may not permit any free service. By law, the City must charge and collect rates sufficient to pay all operating, maintenance, depreciation, replacement, betterment and interest charges of the System and to maintain a debt service interest and sinking fund sufficient to pay any bonds or notes issued to purchase, construct or improve the System or any outstanding indebtedness of the System. See "SECURITY FOR THE SERIES 2009A BONDS—Rate Covenant." Rates for wholesale wastewater services and for sales of water to other political subdivisions on a wholesale basis are subject to the jurisdiction of TCEQ. Pursuant to Texas law, however, the TCEQ may not set a rate which is less than the amount required to meet the debt service and bond coverage requirements of the Water Facilities. Certain disputes as to sales of surface water may also be subject to the jurisdiction of the TCEQ. In setting rates, City Council considers, among other things, the current federal guidelines regarding user charges and certain charges imposed on federal construction grant recipients under the Clean Water Act.

The Master Ordinance provides for automatic annual rate adjustments for the Combined Utility System. See "SECURITY FOR THE SERIES 2009A BONDS — Automatic Annual Rate Adjustments." See "THE CITY AND THE SYSTEM—City Charter Limitations" for a discussion of the limitations on increases in water and sewer rates included in the Proposition 1 amendment to the City Charter approved by voters in November 2004.

In addition to the Master Ordinance and the Previous Ordinance authorizing the issuance of Previous Ordinance Bonds, which requires an annual review of System rates and annual adjustment of rates to assure that revenues are sufficient to provide for debt service on such bonds, City Council has adopted a resolution requiring a similar annual review and adjustment of rates in connection with the payment of Maintenance and Operation expenses of the System, payment of debt service on the System, annexed utility district bonds and payment of certain contract tax obligations related to the construction of water supply and distribution and wastewater collection and treatment facilities. The resolution is a declaration of City policy, but specifically states that it may be amended by City Council at any time and shall not be deemed to be an enforceable obligation of the City. See "SYSTEM DEBT AND CHARGES — Discretionary Debt Service."

The magnitude and frequency of rate increases will depend upon factors such as the rate at which operating expenses increase in the future, the interest rate on System Obligations and other revenue bonds sold to meet the System's future capital requirements, the extent to which System Obligations are used to meet those capital requirements, and the volume of water sold and future changes in environmental requirements. See "SECURITY FOR THE SERIES 2009A BONDS—Automatic Annual Rate Adjustments." See also "THE CITY AND THE SYSTEM—City Charter Limitations" and "SOURCES OF SYSTEM REVENUES." See also the section captioned "QUALIFIED HEDGE AGREEMENTS" for a discussion of the possible impact on rates in connection with the risks associated with Qualified Hedge Agreements.

Water and Sewer Rate Study

Periodically, the City commissions water and sewer rate studies to assess the adequacy and equitability of its rates. The last such study was prepared by Black & Veatch, the City's utility rate consultant, and was completed in March 2004. That study recommended the water and sewer rate increases that were adopted in April 2004. The City expects that it will commission a new water and sewer rate study in Fiscal Year 2009 or 2010.

Current Rates

Water and Sewer Rates. In April 2004, City Council adopted a water and sewer rate increase that was reflected in customer billings as of June 2004. On April 1, 2005 the first of the automatic annual rate adjustments provided for in the Master Ordinance went into effect. On March 11, 2009, City Council adopted a one-time water and sewer rate increase of 1.79% in addition to the annual automatic Designated Index adjustment to reflect the growth in the City's population for the most recently available twelve month period. See "SECURITY FOR THE SERIES 2009A BONDS—Automatic Annual Rate Adjustments." Current water and sewer rates are based on customer class and meter size and cost of services. The amount of a customer's sewer bill is the sum of the minimum charge based on meter size and an additional charge based on the volume of consumption above a minimum volume. Water bills are calculated using volume, rounded to whole thousand gallons, multiplied by the appropriate per gallon rate. The water rates vary from $3.44* per thousand gallons for single family customers to $5.27* per thousand gallons for outdoor customers.

Usage of the Sewer Facilities is not metered for rate purposes. Instead, sewer rates are based upon metered water usage, as adjusted for certain unusual requirements. The sewer rates vary from $3.88* + service fee per thousand gallons for single family and multi-family customers to $5.12* per thousand gallons for industrial customers. Additionally, industrial customers may be subject to a sewer surcharge based on the quality of their wastewater discharge.

The bill for a typical single-family residential customer using 6,000 gallons per month would be $44.50* for both water and sewer services. However, the City has lower-user rates ranging from $9.96* to $37.68* per month for water and sewer services for single-family residential customers using less than 6,000 gallons per month, which are below the cost of providing services. See "THE CITY AND THE SYSTEM—City Charter Limitations" for a discussion of certain initiatives that could impact System rates.

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* Amounts reflect the water and sewer rate increase effective as of April 1, 2009. See also "SECURITY FOR THE SERIES 2009A BONDS—Automatic Annual Rate Adjustments."

Schedule 9 — Rate Adjustments

In recent years, the water and sewer rates have been adjusted on the average as follows:

	Average Percent Rate Increase	
Date of Change	**Water**	**Sewer**
July 1988	8.5%	7.6%
August 1989	6.0%	7.5%
July 1990	5.5%	7.5%
February 1992	2.0%	6.0%
March 1993	2.5%	4.0%
June 2004	9.2%	10.1%
April 2005[(1)]	3.5%	3.5%
April 2006[(1)]	3.6%	3.6%
April 2007[(1)]	2.8%	2.8%
April 2008[(1)]	1.8%	1.8%
April 2009[(2)]	5.09%	5.09%

(1) The April 2005 – 2008 rate increases resulted from the automatic annual rate adjustment provisions of the Master Ordinance.

(2) The April 2009 rate increase will result from the automatic rate increase and includes a 1.79% increase to reflect the growth in the City's population for the most recently available twelve month period. See "THE CITY AND THE SYSTEM—City Charter Tax and Revenue Limitations."

See "SECURITY FOR THE SERIES 2009A BONDS—Automatic Annual Rate Adjustments" for a description of the automatic rate adjustment terms of the Master Ordinance. Together with the automatic annual rate adjustments, additional rate increases may be required in order to implement the System's Capital Improvement Plan as currently contemplated.

Billing and Collection

The Department performs billing and collection services for the System. Customers are billed monthly based on metered water consumption, except for certain sewer customers who are billed based on their metered discharge. A bill is due 20 days after the date on which the statement of account was mailed, and late payments incur a ten percent penalty if paid after the next billing. If a customer fails to make payment on or before the 23rd day from the date the bill was mailed, the City sends a second written notice to the customer restating the amount owed and setting forth the procedure by which the customer can discuss any dispute over the propriety of the charge with a customer service representative. Approximately three weeks after the second written notice is mailed, a City field representative is dispatched to the customer's address to collect the past-due billing or to cut off water service.

The City has instituted a number of programs in an effort to improve collections. One program is the passage of a lien ordinance, which authorizes the City to file liens against certain properties with delinquent bills totaling $3,000 or more. Another program is the hiring of a collection agency to assist in the collection of delinquent final bills. All undisputed final bills over 90 days past due are turned over to the collection agency, which is paid a percentage of all collections as a fee. In addition, any customer with a delinquent final bill over 90 days past due will be reported to the local credit bureaus.

SYSTEM CAPITAL IMPROVEMENT PLAN

Capital Improvement Plan

In order to meet the future water and wastewater needs of the Houston metropolitan area and to comply with applicable governmental and environmental regulations, the City continually evaluates System capabilities and makes plans and forecasts to accommodate future requirements in a timely manner. Each year City Council approves a rolling five-year capital improvement plan ("CIP"), which is revised annually to include new projects to reflect changes in priorities established through input from City Council, administration, other departments and

citizens through public hearings. The System's Fiscal Year 2009-2013 CIP approved by City Council reflects appropriations or capital improvements to the System totaling approximately $1.050 billion.

The major goals of the Department's Fiscal Year 2009-2013 CIP are as follows:

Water Facilities Capital Improvements — enhancement of the level of water service, including maintenance of Water Facilities pressures at adequate levels under varying demand conditions; replacement of inadequate Water Facilities components and other improvements to increase the efficiency and reliability of the Water Facilities; development of surface water supplies to permit increased reliance on surface water and to mitigate against subsidence; and surface water treatment facility modifications and Water Facilities expansions.

Sewer Facilities Capital Improvements — repairing and replacing wastewater collection lines to eliminate infiltration; increasing the wastewater transportation capacity; increasing the wet weather treatment capacity of the Sewer Facilities; improvements to increase the efficiency and reliability of the Sewer Facilities; and upgrading the Sewer Facilities to comply with governmental and environmental regulations.

Schedule 10 — Funding of Proposed System Improvements

It is anticipated that the System improvements contemplated in the System's Fiscal Year 2009-2013 CIP will be financed approximately as follows:

	2009-2013 (in millions)
System Bonds [1]	$ 750.0
Other Sources (including System Bonds issued to TWDB)[2]	300.0
Total	$ 1,050.0

[1] The City expects that the System's Fiscal Year 2009-2013 CIP will require the periodic issuance of Additional First Lien Bonds and Commercial Paper Notes issued as Third Lien Obligations. City Council must approve each issuance of First Lien Bonds, but not each issuance of Commercial Paper Notes. See "SYSTEM DEBT AND CHARGES—Commercial Paper Program." The amounts above include net bond proceeds and interest earnings.

[2] Includes loan funds sourced from the Texas Water Development Board and payable by the City as System Bonds.

Federal and State Funds

General. The Texas Water Development Board (the "TWDB") administers loan programs to eligible municipalities and agencies. Under the programs, described in more detail below, each state is to receive from the U.S. Environmental Protection Agency ("EPA") a series of grants to establish Clean Water and Safe Drinking Water State Revolving Funds (each an "SRF") from which such state will make loans to eligible recipients. TWDB has adopted a policy to implement the SRF loan programs through the purchase of bonds issued by the loan recipients. Since 1988, the SRF loan programs have provided the City with a means to finance EPA-eligible projects at interest costs below those available in the market through the sale of bonds placed with TWDB. See "SYSTEM DEBT AND CHARGES — Schedule 11 — Obligations Payable from System Revenues." The City intends to continue to utilize such loan programs in future years.

State Clean Water Revolving Fund. One of the loan programs administered by TWDB is the Clean Water SRF. The State Revolving Fund Act, Title VI of the Federal Water Pollution Control Act of 1972, as amended by the Water Quality Act of 1987, as amended (the "Federal Act"), established the Water Pollution Control SRF program (described below) as a joint federal and state program. Under the Water Pollution Control SRF program, the EPA is authorized to make grants (the "SRF Capitalization Grants") to states to aid in providing financial assistance to municipalities; intermunicipal, interstate or state agencies; or other public entities eligible for assistance under the Federal Act (the "Eligible Cities") for publicly-owned wastewater treatment works including storm water and non-point source pollution control projects and other authorized purposes pursuant to the Federal Act. As a

condition to receipt of an SRF Capitalization Grant, a state is required to establish a perpetual state revolving fund into which the SRF Capitalization Grant must be deposited, and to provide state matching funds at least equal to 20% of the SRF Capitalization Grant. Funds in a state revolving fund are permitted to be applied to provide financial assistance to Eligible Cities for publicly-owned wastewater treatment works in a number of ways, including making direct loans, retiring existing debt through refinancing, and loan guarantees.

Pursuant to Chapter 15, Subchapter J of the Texas Water Code, which became effective June 17, 1987, the State of Texas created a Water Pollution Control SRF under the federal program for the purpose of providing loans to political subdivisions for wastewater treatment works including storm water and non-point source pollution control projects and other authorized purposes. TWDB currently provides financial assistance by purchasing political subdivision bonds from Eligible Cities, including the City.

The City issued two separate series of First Lien Bonds on April 21, 2008 and another series of First Lien Bonds on December 30, 2008, all purchased by TWDB, in the respective principal amounts of $45,050,000, $52,650,000 and $61,545,000, respectively, in connection with TWDB's Clean Water SRF.

State Safe Drinking Water Revolving Fund**.** Another loan program administered by TWDB is the Safe Drinking Water SRF. The Safe Drinking Water Act, 42 U.S.C. § 300 *et seq.,* as reauthorized in 1986 and amended in 1996 (the "SDWA"), established national primary drinking water regulations to protect the safety of the public's drinking water. Under the SDWA, the EPA is authorized to make grants ("DWSRF Capitalization Grants") to states to assist communities in meeting established drinking water standards. As a condition to receipt of a DWSRF Capitalization Grant, a state is required to establish a Safe Drinking Water SRF into which the DWSRF Capitalization Grant must be deposited, provide state matching funds at least equal to 20% of the DWSRF Capitalization Grant for deposit in the DWSRF and comply with certain other requirements of the SDWA. DWSRF funds are permitted to be applied to provide financial assistance to community water systems and non-profit community water systems in a number of ways, including making direct loans, retiring existing debt through refinancing, and providing loan guarantees for expenditures that facilitate compliance with the primary national drinking water regulations.

Pursuant to Chapter 15, Subchapter J of the Texas Water Code, the State of Texas created a Safe Drinking Water SRF under the federal program for the purpose of providing loans to political subdivisions and water supply corporations. TWDB currently provides financial assistance by purchasing political subdivision bonds from Eligible Cities, including the City. The Texas Legislature expanded the program, effective September 1, 1997, to allow funding for privately owned corporations for loan subsidies, provided that only appropriated funds and federal grants are utilized for such purpose.

Other. TWDB provided the initial amount of approximately $14 million in State Participation Funds relating to the acquisition of an ownership interest in the Allen's Creek Reservoir project. For further information, see "THE CITY AND THE SYSTEM — Water Facilities — Regional Planning."

CUS General Purpose Fund

The City from time to time may use amounts on deposit in the CUS General Purpose Fund to finance capital improvements to the System. Amounts in the CUS General Purpose Fund are generated primarily from Net Revenues of the System after payment of all System Obligations. The availability of such amounts for capital improvement purposes will be dependent upon the System's ability to generate sufficient Net Revenues.

SYSTEM DEBT AND CHARGES

Schedule 11 — Obligations Payable from System Revenues

The following schedule sets forth the total outstanding principal amount of System Obligations payable from revenues of the System as of February 28, 2009 and has been adjusted to include the Series 2009A Bonds (see "PURPOSE AND PLAN OF FINANCE"):

Obligations Payable from System Revenues	As of February 28, 2009[1]
Contract Revenue Bonds Payable from System Gross Revenues	
CWA Bonds[2]	$166,490,000
TOTAL	166,490,000
System Bonds Payable from System Net Revenues[3]	
Previous Ordinance Bonds[4]	$748,885,000
First Lien Bonds	4,658,940,000
Third Lien Obligations[5]	0
TOTAL	5,407,825,000
TOTAL – All Obligations Payable from System Revenues	$5,574,315,000

(1) Unaudited information as reported in the City's Monthly Financial and Operations Report dated as of February 28, 2009.

(2) See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE" and "THE CITY AND THE SYSTEM — Water Facilities — Treated Water Supply Contracts." This amount does not include $28 million in bonds issued by CWA for the Luce Bayou Project. See "THE CITY AND THE STATE—Water Facilities—Water Supply Contracts."

(3) Excludes the principal amount of bonds payable from Discretionary Debt Service transfers of the System. See "SYSTEM DEBT AND CHARGES — Discretionary Debt Service."

(4) Previous Ordinance Bonds include Outstanding Junior Lien Bonds (including bonds placed with TWDB). Does not include $155.2 million in accreted value of Previous Ordinance Bonds issued as capital appreciation bonds at this date. See "SYSTEM NET REVENUES AVAILABLE FOR DEBT SERVICE — Schedule 1 — Net Revenues of the System and Debt Service Coverage."

(5) Represents Commercial Paper Notes issued as Third Lien Obligations under the Master Ordinance.

Commercial Paper Program

The City currently issues Combined Utility System Commercial Paper Notes, Series A (the "Series A Notes" or the "Commercial Paper Notes") periodically pursuant to the Master Ordinance and a Supplemental Ordinance authorizing the issuance of the Series A Notes in an aggregate amount not to exceed $900,000,000. The program is structured as a revolving Commercial Paper Note program. The Series A Notes are secured by lines of credit from WestLB, AG, Bayerische Landesbank, Landesbank Baden-Württemberg, and Dexia Credit Local, each acting through their respective New York branches. WestLB, AG, is the administrative agent of the various credit banks under the Series A Note program.

Series A Notes may be issued for a period not to exceed 270 days and bear interest at a rate not to exceed 10%. Series A Notes are offered and remarketed by Commercial Paper Note dealers. Series A Notes are issued as Third Lien Obligations and are payable from and secured by a lien on Net Revenues of the System which is subordinate to the lien securing payment of First Lien Bonds. Proceeds of Series A Notes are used to finance various capital projects of the System.

Current Credit Market Issues

During the past twelve months, certain of the City's variable rate debt secured by the Net Revenues has been held by the liquidity provider (the "Liquidity Provider") because the debt was not successfully remarketed. As of the date hereof, certain outstanding Combined Utility System 2008D-2 variable rate bonds to be redeemed and discharged from proceeds of the Series 2009A Bonds are currently held by the Liquidity Provider. Additionally, as of March 12, 2009, approximately, $1.2 million in principal amount of the City's outstanding Series 2008D-3 Bonds

are held by the Liquidity Provider (the "Liquidity Bank Bonds"). The City is currently paying rates of interest on the Liquidity Bank Bonds within budgeted amounts for this Fiscal Year. The Liquidity Bank Bonds bear interest at rates of interest established from time to time under the applicable liquidity agreement.

Discretionary Debt Service

Under the budgeting policy of the City, the debt service on public improvement bonds issued for sanitary sewer purposes prior to 1976, contract tax obligations relating to the construction of water treatment and sanitary sewer facilities and debt service on assumed water district bonds attributable to water treatment and sanitary sewer facilities ("Discretionary Debt Service") were paid from the Net Revenues of the System out of the Renewal and Replacement Fund, although there was no legal requirement to do so and although such Discretionary Debt Service is secured by a pledge of ad valorem taxes. The City has paid Discretionary Debt Service out of the CUS General Purpose Fund. See "SYSTEM CAPITAL IMPROVEMENT PLAN — CUS General Purpose Fund" and "SECURITY FOR THE SERIES 2009A BONDS — Flow of Funds."

Schedule 12 — Discretionary Debt Service Paid by the System

The following schedule shows the total amount of Discretionary Debt Service paid from Net Revenues of the System for the Fiscal Years shown below:

Fiscal Year	Discretionary Debt Service (in millions)
2005	$28.2[1]
2006	26.3[1]
2007	24.7[1]
2008	25.8[1]
2009 (projected)	28.4[2]

(1) As reported in the Statistical Section of the City of Houston Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008.
(2) Unaudited information as reported in the City's Fiscal Year 2009 Budget adopted on June 18, 2008.

Contract Tax Obligations

Texas law authorizes the City to incur or, through annexation, to assume, "Contract Tax Obligations," which are substantially equivalent to ad valorem tax bonds, through the pledge of ad valorem tax receipts for the payment of contracts for water and sewer services with other political subdivisions or non-profit corporations. The City currently has no outstanding Contract Tax Obligations, but may incur such obligations in the future.

Indirect Charges Paid by the System and CUS General Purpose Fund Transfers

Indirect Charges Paid by the System. Charges have been made on a cost allocation basis by the City's General Fund to the Water and Sewer System's revenue fund under the Previous Ordinance and will continue to be made to the Revenue Fund for the Combined Utility System for certain indirect charges incurred by the General Fund on behalf of the System. These indirect charges are payable out of the Revenue Fund as Maintenance and Operation Expenses of the System.

Schedule 13 — Indirect Charges Paid by the System and CUS General Purpose Fund Transfers

Schedule 13A — Indirect Charges Paid by the System

The following schedule shows the total amount of such indirect charges for the Fiscal Years shown below:

Fiscal Year	Indirect Charges (in millions)
2005	$1.236[1]
2006	2.157[1]
2007	2.309[1]
2008	0.923[1]
2009 (budget).....	2.324[2]

(1) As reported in the Statistical Section of the City of Houston Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008.
(2) Unaudited information as reported in the City's Fiscal Year 2009 Budget adopted as of June 18, 2008.

CUS General Purpose Fund Transfers to Storm Water Fund. Under the Previous Ordinance, the City utilized different means for funding costs associated with its storm water management system, including transferring available water and sewer revenues into a Drainage Utility Fund created by an ordinance originally adopted by City Council in 1992 and amended a number of times thereafter (as amended, the "Drainage Utility Fund Ordinance"). Under the Master Ordinance, the City intends to fund costs associated with its storm water management system from permitted transfers from the CUS General Purpose Fund (as described in the section captioned "SECURITY FOR THE SERIES 2009A BONDS — CUS General Purpose Fund") to the Storm Water Fund, described below.

In April 2004, the City adopted an ordinance further amending the ordinance that established the Drainage Utility Fund. The April 2004 amending ordinance renamed the Drainage Utility Fund as the Storm Water Fund and provided that all funds transferred from time to time from the CUS General Purpose Fund of the Master Ordinance are required to be deposited to the Storm Water Fund. The amending ordinance also provided that monies deposited in the Storm Water Fund may be used only for the planning, design, construction, regulation, improvement, repair, maintenance, and operation of facilities and programs relating to the system or network of storm water management facilities including, but not limited to, inlets, conduits, manholes, channels, ditches, drainage easements, retention and detention basin, infiltration facilities, and other components. The amending ordinance provides that this includes (i) the costs of developing, implementing, and enforcing a storm water management program to reduce the discharge of pollutants from the City's storm sewer system and protect water quality, and the costs related to obtaining, renewing, or maintaining any required permits related to the operation of the storm sewer system, and (ii) payment of debt service on bonds, notes, or other obligations issued for the purposes listed in this paragraph. The following schedule shows the total amount of transfers from the CUS General Purpose Fund to the Storm Water Fund for the Fiscal Years shown below:

Schedule 13B — CUS General Purpose Fund Transfers- Storm Water Fund

Fiscal Year	CUS General Purpose Fund Transfers (in millions)
2005	$30.0[1]
2006	31.3[1]
2007	34.1[1]
2008	36.5[1]
2009 (projected).....	39.4[2]

(1) As reported in the Statistical Section of the City of Houston Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008.
(2) Unaudited information as reported in the City's Fiscal Year 2009 Budget adopted as of June 18, 2008.

Schedule 14 —System Debt Service Schedule

The following schedule sets forth the principal and interest requirements on all outstanding bonds (including the Bonds and excluding the Refunded Bonds) payable from revenues of the System for each of the City's fiscal years ending June 30 as shown below, based on footnoted assumptions. The following schedule also does not include Discretionary Debt Service payments or Commercial Paper Notes issued as Third Lien Obligations under the Master Ordinance.

Fiscal Year Ending June 30	Total Bonds Payable From System Gross Revenues[1]	Bonds Payable From System Net Revenues			
		Previous Ordinance Bonds	First Lien Bonds	Total Bonds	Total Debt Service[1]
2009	28,103,216	73,353,595	230,878,511	304,232,106	332,335,322
2010	23,817,045	82,267,989	268,563,583	350,831,572	374,648,617
2011	21,368,014	87,168,868	265,301,401	352,470,269	373,838,283
2012	20,587,020	107,856,772	249,646,099	357,502,871	378,089,891
2013	19,835,276	107,188,212	259,960,076	367,148,288	386,983,564
2014	19,044,520	77,804,468	294,549,006	372,353,474	391,397,994
2015	18,246,663	89,521,320	286,325,998	375,847,318	394,093,981
2016	18,033,409	89,184,040	288,579,556	377,763,596	395,797,005
2017	7,555,646	80,800,280	296,890,939	377,691,219	385,246,865
2018	6,750,045	52,112,098	325,573,470	377,685,568	384,435,613
2019	6,741,133	139,219,336	238,724,188	377,943,524	384,684,657
2020	6,737,859	56,297,338	321,645,220	377,942,558	384,680,417
2021	6,755,185	43,100,950	334,822,509	377,923,459	384,678,644
2022	6,718,061	36,151,869	341,618,829	377,770,698	384,488,759
2023	6,711,187	33,247,860	344,508,674	377,756,534	384,467,721
2024	6,703,313	34,487,039	343,141,499	377,628,538	384,331,851
2025	6,693,939	33,357,575	344,326,748	377,684,323	384,378,262
2026	7,662,440	18,155,000	359,225,978	377,380,978	385,043,418
2027	3,550,050	30,815,000	345,409,126	376,224,126	379,774,176
2028	3,550,050	30,810,000	345,627,011	376,437,011	379,987,061
2029	3,547,925	44,095,000	331,815,380	375,910,380	379,458,305
2030	3,547,844	0	376,114,087	376,114,087	379,661,931
2031	3,544,844	0	375,829,093	375,829,093	379,373,937
2032	3,540,550	0	376,457,692	376,457,692	379,998,242
2033	3,534,725	0	375,375,201	375,375,201	378,909,926
2034	3,532,013	0	375,603,174	375,603,174	379,135,187
2035	3,531,938	0	183,621,127	183,621,127	187,153,065
2036	0	0	183,626,534	183,626,534	183,626,534
2037	0		160,869,536	160,869,536	160,869,536
2038			74,986,269	74,986,269	74,986,269
2039			69,256,706	69,256,706	69,256,706
Total	269,943,910	1,346,994,609	8,968,873,220	10,315,867,829	10,585,811,739

[1] Includes CWA Bonds. Series 2008 D1,2,3 variable rate bond debt service is calculated using current market fixed rates. Debt service is calculated based on an assumed taxable rate with a maturity on the applicable tax-exempt conversion date. After the applicable Tax-Exempt Conversion Date, debt service is calculated using a long term tax-exempt rate to maturity. $249,075,000 of the Series 2008A-1,2 variable rate bond debt service is calculated at the fixed payor swap rate of 3.761%. Series 2004-B debt service is adjusted to take into account expected payments under the Series 2004-B Qualified hedge agreements.

EMPLOYEE PENSION FUNDS

General Overview

Pension Systems. The City has three pension programs that cover all full time City employees: the Houston Municipal Employees Pension System ("HMEPS" or the "Municipal System") for municipal employees, including virtually all Combined Utility System employees; the Houston Police Officers' Pension System ("HPOPS" or the "Police System") for classified police officers; and the Houston Firefighters' Relief and Retirement Fund ("HFRRF" or the "Firefighter Fund") for classified firefighters (collectively, the "Pension Systems"). The Pension Systems were established in accordance with State law, with the Municipal System established pursuant to Article 6243h of the Vernon's Texas Civil Statutes, as amended, (the "HMEPS Statute"), the Police System established pursuant to Article 6243g-4, as amended, (the "HPOPS Statute ") and the Firefighter Fund established pursuant to Article 6243e.2(1), as amended (the "HFRRF Statute," collectively with the HMEPS Statute and the HPOPS Statute, the "Pension Statutes").

The Pension Statutes establish the governance structures of the Pension Funds, City and employee contribution levels, and the determination of benefits payable to retirees under the Pension Systems; provided, however, that the HMEPS and HPOPS Statutes establish a local "meet and confer" process through which the City and the boards of trustees of the Municipal System and the Police System may reach binding agreements regarding City and employee contribution levels and the determination of benefits payable to retirees. Such agreements may provide for contribution levels and determinations of benefits that differ from those provided in the Pension Statutes.

Substantially all of the Combined Utility System's employees are members of the Municipal System. Thus, while anticipated increases in City contributions to the Police System and Firefighter Fund will have an effect on the Combined Utility System due to increases in the cost of reimbursing the City's General Fund for security and fire protection services, the Combined Utility System is directly responsible for only the costs of funding the portion of the Municipal System associated with the employees of the Combined Utility System. See "—Combined Utility System Contributions to the Municipal System."

Funding Status. Since 2001, the Municipal System has experienced increasing actuarially determined contributions and their component UAALs. Such increases primarily stem from the adoption by the Texas Legislature in 2001 of increased benefit levels for municipal employees. These benefit changes were supported jointly by the City and representatives of the Municipal System based on an actuarial cost analysis performed by the Municipal System's actuary, which showed that the City contribution to the Municipal System as a percentage of payroll could be expected to rise to approximately 14.7% as a result of the changes. The 2001 benefit changes in combination with lower than expected investment performance resulted in actuarially determined net contributions of 52.8% of payroll as of July 1, 2003.

In order to address the past increases in actuarially determined contributions and the component UAAL, the City has taken a number of actions to improve the financial condition of the Municipal System. Pursuant to an election held on May 15, 2004, the voters authorized the City to opt-out of an amendment to the Texas Constitution that prohibits (unless the jurisdiction "opts out") a reduction in or other impairment of the retirement or death benefits provided by the public retirement systems of political subdivisions that a member of such a system has "accrued." In addition, the City and the Municipal System entered into a "meet and confer" agreement in 2004 (the "2004 HMEPS Agreement"), which effectively reduced the City's actuarially determined contribution amount to a level of approximately 24% of payroll. The 2004 HMEPS Agreement was considered by the City to be an intermediate step toward addressing the unexpected financial challenges arising from the 2001 benefit increases. To provide a more permanent, long term solution to those financial challenges, the City and the Municipal System subsequently entered into an amendment to the 2004 HMEPS Agreement (the "2007 HMEPS Agreement," together with the 2004 HMEPS Agreement, the "HMEPS Agreements") regarding benefit levels for current and future employees and employee and certain City contributions. See "—HMEPS Agreements" for a more complete description of the HMEPS Agreements.

As a result of the City's funding commitment, increased employee contributions and reduced benefits contained in the HMEPS Agreements, the UAAL of the Municipal System has been decreased from approximately $1.8 billion as of July 1, 2003 to approximately $935 million as of July 1, 2007.

While in the near term the City contributions are expected to continue to be less than the actuarially determined amounts, the City believes that over the long term, the combination of the benefit reductions and future expected City contributions made pursuant to the HMEPS Agreements will have the effect of reducing future actuarially determined contribution amounts and their component UAALs. Current actuarial projections indicate that the actual City contributions will equal the actuarially determined contributions within the next five to ten years. Further, the projected assets of the Municipal System are expected to be sufficient to pay benefits to all employees when they become due. The projections of assets and actuarially determined contributions depend on a variety of factors including the rate of return, investment performance and future contributions by the City.

Combined Utility System's Contributions to Municipal Pension System. The City budgets for its contributions to the Municipal System by allocating the cost among its General Fund and various Enterprise Funds based upon the percentage of total payroll paid by the funds. For Fiscal Year 2008, municipal employees of the Combined Utility System comprised approximately 17% of the total civilian workforce payroll of the City, and accordingly, the Combined Utility System was responsible for approximately this percentage of the pension contributions for the Municipal System. To the extent the share of budgeted payroll for municipal employees of the Combined Utility System changes in the future, the allocable percentage of the budgeted contributions by the Combined Utility System to the Municipal System will also change.

As a result of the HMEPS Agreements, the Combined Utility System made payments to the Municipal System of $11.8 million in Fiscal Year 2006, $12.3 million in Fiscal Year 2007, and 13 million in Fiscal Year 2008. For a discussion of the HMEPS Agreements, see "HMEPS Agreements" below. The City and HMEPS have approved an agreement with respect to the City's funding commitment to the Municipal System for Fiscal Years 2008 through 2011, which requires the City to make a contribution of approximately $78.5 million in Fiscal Year 2009, which matches the contribution contained in the Fiscal Year 2009 Budget. Without this agreement, the City's contribution level would be established pursuant to the HMEPS statute and would result in a contribution of approximately $110 million.

In addition, the City issued its Taxable General Obligation Pension Bonds, Series 2004C (the "Series 2004C Pension Bonds"), Series 2006 (the "Series 2006 Pension Bonds") and Series 2007A (the "Series 2007A Pension Bonds") to meet its obligations under its "meet and confer" agreements. The City paid $33 million of the proceeds of each series of bonds to the Municipal System. Although these bonds are secured by a pledge of ad valorem tax revenues, the Combined Utility System is responsible for repaying its pro-rata share of debt service of $179,000 annually of the Series 2004C Pension Bonds issued in Fiscal Year 2005 for its benefit. This debt service payment is in addition to the Combined Utility System's annual contribution to HMEPS based on the current payroll of active employees. The Combined Utility System has no responsibility for debt service on the Series 2006 Pension Bonds or the Series 2007A Pension Bonds because it is fully paying its share of pension contributions as determined by "meet and confer" agreements from operating revenues. The Combined Utility System is also currently responsible for 17.2% of the debt service on the City's Taxable Pension Obligation Refunding Bonds, Series 2008A, which refunded a $300 million collateralized pension obligation note delivered by the City to the Municipal System.

HMEPS Agreements. The 2004 HMEPS Agreement was effective as of September 15, 2004, and was extended by the 2007 HMEPS Agreement to June 30, 2012. The 2004 HMEPS Agreement has three elements, (1) a funding commitment by the City for Fiscal Years 2005, 2006 and 2007, including a commitment to contribute cash, issue Pension Obligations, and contribute certain City assets; (2) a required increase in the employees' contribution; and (3) benefit level reductions for employees hired prior to January 1, 2008. The 2007 HMEPS Agreement has three elements, (1) a funding commitment by the City for Fiscal Years 2008, 2009, 2010, and 2011, (2) a new noncontributory defined benefit plan with further reduced benefit levels for employees hired after January 1, 2008, and (3) an agreement to reset the actuarial value of the Municipal System Assets to the market value of such assets as of July 1, 2006.

Under the terms of the 2007 HMEPS Agreement, the City will make contributions to the Municipal System of $75 million in Fiscal Year 2008, $78.5 million in Fiscal Year 2009, $83.5 million in Fiscal Year 2010, and $88.5 million in Fiscal Year 2011. The Combined Utility System will be responsible for approximately 17.3% of the City's scheduled contributions based upon the current percentage of City's total municipal employee payroll paid by the Combined Utility System.

BONDHOLDERS' REMEDIES

The Master Ordinance makes no provision for the appointment of a trustee to protect the rights of owners of any such obligations, and no provision for acceleration of maturity of any such bonds or foreclosure on revenues or possession of revenues by a trustee or agent for owners of any such obligations, or operation of the System by an independent third party in the event of default.

No lien has been created on the physical properties comprising the System to secure payment of principal of or interest on any revenue bonds of the System. Moreover, in the event of default, the owners of such obligations have no right or claim under the laws of the State against the System or any property of the City other than their right to payment from revenues collected and certain funds maintained pursuant to the Master Ordinance. Texas courts have held that unless expressly waived by the Texas Legislature, a municipality is immune from suit for monetary damages, and that the statutory authorization for municipalities to plead or be impleaded is insufficient to constitute a waiver of sovereign immunity. Accordingly, the only practical remedy in the event of default may be a mandamus or other equitable remedy proceeding to compel the City to increase rates and charges or to perform its other obligations under the Master Ordinance and any Amended Supplemental Ordinance authorizing the issuance of System Obligations. Such remedy may need to be enforced on a periodic basis because maturity of such bonds is not subject to acceleration. In addition, even if rates and charges are increased, the amount of revenues generated would depend upon usage of the System by third parties, which is beyond the control of the City.

The enforcement of a claim for payment of principal of or interest on any revenue bonds of the System and the City's other obligations with respect to such bonds is subject to the applicable provisions of the federal bankruptcy laws and to any other similar laws affecting the rights of creditors of political subdivisions generally. See also "CERTAIN COVENANTS AND TERMS OF THE MASTER ORDINANCE — Bondholder Rights and Remedies."

LITIGATION AND REGULATION

Claims and Litigation Affecting the City

The City is a defendant in various lawsuits and is aware of pending claims arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. That litigation includes lawsuits claiming damages that allege that the City caused personal injuries and wrongful deaths; class actions and other lawsuits and claims alleging discriminatory hiring and promotion practices and certain civil rights violations arising under the Federal Voting Rights Act; various claims from contractors for additional amounts under construction contracts; and claims involving property tax assessments and various other liability claims. The status of such litigation ranges from an early discovery stage to various levels of appeal of judgments both for and against the City. The amount of damages is limited in certain cases under the Texas Tort Claims Act and is subject to appeal. The City intends to defend itself vigorously against the suits; however, no prediction can be made, as of the date hereof, with respect to the liability of the City for such claims or the final outcome of such suits. See also "THE CITY AND THE SYSTEM—Redistricting."

The City is also aware that various claims for inverse condemnation may be asserted against the City in connection with operations of the System, the aggregate amounts of which are unknown. In particular, a Texas Court of Appeals has awarded a group of plaintiffs an amount, which, with interest, exceeds $26 million, for the alleged inverse condemnation of their mineral rights under and in the vicinity of Lake Houston. The City has filed a petition for review of such award with the Texas Supreme Court. The City intends to defend itself vigorously against such award and all other inverse condemnation claims; however the City's liability with respect to these claims cannot be predicted. See also the section captioned "THE CITY AND THE SYSTEM—City Charter Limitations" and Note 13 to the Financial Statements for Fiscal Year 2006 as set forth in APPENDIX A.

Environmental Regulation

The City is subject to the environmental regulations of the State and the United States applicable to the operation of its water supply, wastewater treatment and solid waste disposal systems. These laws and regulations are subject to change, and the City may be required to expend substantial funds to meet the requirements of such

regulatory authorities. Failure to comply with these laws and regulations may result in the imposition of administrative, civil and criminal penalties, or the imposition of an injunction requiring the City to take or refrain from taking certain actions. In addition, the City may be required to remediate contamination on properties owned or operated by the City. See "THE CITY AND THE SYSTEM — Water Facilities — Water Quality," "THE CITY AND THE SYSTEM — Sewer Facilities — Federal and State Regulation of the Sewer Facilities," and "— Potential Penalties for the System's Violations." See also "EFFECTS OF SUBSIDENCE."

Other Environmental Measures

Air quality control measures required by the United States Environmental Protection Agency (the "EPA") and the Texas Commission on Environmental Quality ("TCEQ") may curtail new industrial, commercial and residential development in Houston and adjacent areas. Under the Clean Air Act Amendments of 1990, the eight county Houston-Galveston-Brazoria area ("HGB area") has been designated by the EPA as a severe non-attainment area under the EPA's "one-hour" ozone standard, and as a moderate non-attainment area under the EPA's newer "eight-hour" ozone standard. Such areas are required to demonstrate progress in reducing ozone concentrations each year until compliance with EPA's ozone standards is achieved. To provide for annual reductions in ozone concentrations, the EPA and the TCEQ have imposed increasingly stringent limitations on emissions of volatile organic compounds and nitrogen oxides ("NOx") from existing stationary sources of air emissions. In addition, any new source of significant air emissions, such as a new industrial plant, must provide for a net reduction of air emissions by arranging for other industries to reduce their emissions by 1.3 times the amount of pollutants proposed to be emitted by the new source. Even though existing air emissions controls, originally imposed in an effort to achieve compliance with the one-hour ozone standard, are quite stringent, studies have indicated that even more stringent air emissions controls will be necessary in order for the HGB area to achieve compliance with the new eight-hour ozone standard. In May 2007, the TCEQ adopted a plan to impose additional controls on sources of air emissions in the HGB area that are intended to demonstrate progress in achieving compliance with the eight-hour ozone standard, and the TCEQ's plan was submitted to the EPA for approval in June 2007. Due to the magnitude of air emissions reductions required as well as shortage of economically reasonable control options, the development of a successful air quality compliance plan has been and continues to be extremely challenging and will inevitably impact a wide cross-section of the business and residential community. In addition, on March 12, 2008, the EPA announced its intention to lower its eight-hour ozone standard by 12%, from 0.084 parts per million (ppm) to 0.075 ppm. This new, lower eight-hour standard for ozone will be even more difficult for the HGB area to achieve.

Given the very significant reductions in air emissions that will be required over the next few years in order for the HGB area to achieve compliance with the eight-hour ozone standard and the difficulties inherent in replacing fleets of vehicles and other heavy equipment, such as locomotive engines, with new ultra low emission fleets, on June 15, 2007, the Governor of Texas requested that EPA "bump-up" the HGB area from a moderate to a severe non-attainment area with respect to the eight-hour ozone standard. The EPA published notice of its approval of the Governor's request on October 1, 2008. As a result of the HGB area's reclassification as a severe non-attainment area under the eight-hour ozone standard, the deadline for achieving compliance has been extended to June 15, 2019. If the HGB area fails to demonstrate progress in reducing ozone concentrations or fails to meet EPA's ozone standards by the deadline for severe non-attainment areas, EPA may impose a moratorium on the awarding of federal highway construction grants and other federal grants for certain public works construction projects, as well as severe emissions offset requirements on new major sources of hydrocarbon emissions for which construction has not already commenced.

Other constraints on economic growth and development include lawsuits filed under the Clean Air Act by plaintiffs seeking to require emission reduction measures that are even more stringent than those adopted by TCEQ and approved by EPA. From time to time, various plaintiff environmental organizations have filed lawsuits against TCEQ and EPA seeking to compel the early adoption of additional emission reduction measures, many of which could make it more difficult for businesses to construct or expand industrial facilities or which could result in travel restrictions or other limitations on the actions of businesses, governmental entities and private citizens. Any successful court challenge to the currently effective air emissions control plan could result in the imposition of even more stringent air emission controls that could threaten continued growth and development in the HGB area.

It remains to be seen exactly what steps will ultimately be required to meet federal air quality standards, how the EPA may respond to developments as they occur, and what impact such steps and any EPA responses may have upon the economy and the business and residential communities in the HGB area.

STATE LEGISLATION

The 81st Texas Legislature (the "Legislature") convened on January 13, 2009. This Official Statement reflects Texas law as currently in effect. While in session, the Legislature may introduce legislation that if enacted could materially affect the operations of the System. The City is unable to project what, if any, impact the changes in Texas law in the current legislative session may have on the cost of System operations or the collection or System revenues.

Although the City is a home-rule city under the Texas Constitution, it may not adopt ordinances or charter provisions inconsistent with Texas law.

RATINGS

Fitch Ratings ("Fitch"), Moody's Investors Service ("Moody's"), and Standard & Poor's Rating Services ("Standard & Poor's") are expected to assign municipal bond ratings of "AAA", "Aa2", and "AAA", respectively, to the Series 2009A Bonds on the understanding that the standard municipal bond insurance policy of Assured Guaranty insuring the payment of the principal of and interest due with respect to the Series 2009A Bonds will be issued by Assured Guaranty upon the issuance of the Series 2009A Bonds. See "BOND INSURANCE." Fitch, Moody's and Standard & Poor's have assigned underlying ratings of "AA", "A+", and "A1" to the System. Ratings reflect only the views of the rating agencies, from whom an explanation of the significance of such ratings may be obtained. The City is not obligated to maintain the current ratings on the Series 2009A Bonds or other outstanding First Lien Bonds, and there is no assurance that ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely if, in the judgment of the rating agency, circumstances so warrant. Any such downward revision or withdrawal could have an adverse effect on the market price of the Series 2009A Bonds or other outstanding First Lien Bonds. The City and the Co-Financial Advisors will undertake no responsibility to oppose any revision or withdrawal of such ratings.

RESERVE FUND

First Lien Bonds

In order to satisfy its reserve fund requirement for previously issued First Lien Bonds, the City previously acquired a Reserve Fund Surety Policy from MBIA Insurance Corporation ("MBIA"), two Reserve Fund Surety Policies from Financial Security Assurance ("FSA"), and an additional First Lien Bond Reserve Fund Surety Policy from Assured Guaranty Corp. ("Assured Guaranty," MBIA, FSA, and Assured Guaranty are jointly referred to herein as the "Reserve Fund Surety Providers"). See "SECURITY FOR THE SERIES 2009A BONDS—First Lien Bond Reserve Fund." In connection with the City's issuance of $61,545,000 in additional First Lien Obligations on December 30, 2008, the City deposited cash in the amount of $2,873,873 in the Debt Service Reserve Fund. In connection with the issuance of the Series 2009A Bonds, the City will deposit $16,950,000 in cash in the Debt Service Reserve Fund to satisfy the increase in the First Lien Participant Reserve Requirement. The Reserve Fund Surety Policies serving the First Lien Bonds are as follows:

Policy	Amount	Year of Termination
Reserve Fund Policy-MBIA (2004)	$ 143,396,956.25	2034
Reserve Fund Policy-FSA (2005)	5,000,000.00	2035
Reserve Fund Policy-FSA (2007)	16,475,000.00	2036
Reserve Fund Policy-Assured Guaranty (2008)	3,537,643.00	2037

The reserve fund requirements for such First Lien Bonds may be reduced by any reduction in the principal amount of such outstanding First Lien Bonds. The Reserve Fund Surety Policies terminate in the years indicated above. In the event the City does not obtain a replacement Reserve Fund Surety Policy or Policies in a sufficient amount by such termination dates, the City will be required to provide for any resulting deficiency in the shared Bond Reserve Fund established for the First Lien Bonds electing to participate in the shared Bond Reserve Fund by making monthly transfers over a 60-month period. See "SECURITY FOR THE SERIES 2009A BONDS—First Lien Bond Reserve Fund."

If amounts in the Debt Service Reserve Fund must be transferred to pay amounts coming due on any Outstanding First Lien Bonds, any cash and/or investments must be drawn first and applied pro-rata before drawing on the Reserve Fund Surety Policies. Draws on the Reserve Fund Surety Policies must also be applied pro-rata after applying cash and/or investments. If amounts then on deposit in the Debt Service Reserve Fund (including the amount of any Reserve Fund Surety Policy) exceed the Reserve Fund Requirements on the First Lien Bonds, the City may transfer such excess to the Revenue Fund. See APPENDIX D—EXCERPTS OF MASTER ORDINANCE. Money deposited in the Debt Service Reserve Fund may, at the option of the City, be deposited in investments permitted by state law and consistent with the City's investment policy.

Pursuant to the Master Ordinance, any provider of a Reserve Fund Surety Policy must be rated, at the time of deposit of such Reserve Fund Surety Policy, in the highest rating category by each Rating Agency rating the Outstanding Bonds to which the Reserve Fund Surety Policy relates at the time of deposit of such Reserve Fund Surety Policy. Any subsequent downgrade of any such provider will not affect the sufficiency of the Reserve Fund. For additional information on each Reserve Fund Surety Provider, see: www.mbia.com, www.fsa.com, and www.assuredguaranty.com, respectively. The Reserve Fund Surety Providers have not reviewed or approved this Official Statement. No assurance can be given by the System, the City or the Remarketing Agents with respect to the Reserve Fund Surety Policies.

Recent developments adversely affecting the insurance business may also be applicable to the providers of Reserve Fund Surety Policies. See "FINANCIAL GUARANTY INDUSTRY—RECENT EVENTS".

Previous Ordinance Bonds

The City has ten Previous Ordinance Bond Reserve Fund Surety Policies outstanding in the aggregate amount of $205,212,378, as follows: (A) three policies with MBIA totaling $110,508,599; (B) four policies with Financial Guaranty Insurance Corporation ("FGIC") totaling $72,596,746; (C) two policies with Ambac Assurance Corporation ("Ambac") totaling $17,064,973; and (D) one policy with FSA totaling $5,042,060. Since the policies were issued, Ambac, FGIC, MBIA, and FSA have been downgraded by one or more of Moody's, S&P, and Fitch. The downgrading of a provider of a Previous Ordinance Bond Reserve Fund Surety Policy does not affect the sufficiency of such policy for purposes of the Previous Ordinance Bond Reserve Fund Requirement. Additional information on such policies is available from the City upon request.

FINANCIAL GUARANTY INDUSTRY – RATINGS

Fitch, Moody's, and Standard and Poor's (collectively referred to herein as the "Rating Agencies") have each released statements on the health of the financial guaranty industry that cite financial guarantors' exposure to subprime mortgage risk as an area of stress for the financial guaranty industry. In various releases, the Ratings Agencies have each outlined the processes that they intend to follow in evaluating the effect of this risk on their respective ratings of financial guarantors. For some financial guarantors, the result of such evaluations has been or could be a rating affirmation, a change in rating outlook, a review for downgrade, or in the case of FSA and Assured Guaranty, both of whom are currently surety providers of the Combined Utility System, a downgrade. Potential investors are directed to the Rating Agencies for additional information on their respective evaluations of the financial guaranty industry and individual financial guarantors. The scheduled payment on the principal of and interest on the Series 2009A Bonds is secured by the Policy. See "BOND INSURANCE".

LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS

Under Texas law, the Bonds are legal and authorized investments for insurance companies, fiduciaries or trustees, and for the sinking fund of cities, towns, villages, school districts and other political subdivisions or public agencies of the State. The Bonds are eligible to secure deposits of any public funds of the State, its agencies and political subdivisions and are legal security for those deposits to the extent of their market value. For political subdivisions in Texas which have adopted investment policies and guidelines in accordance with the Public Funds Investment Act (Texas Government Code, Chapter 2256), the Bonds may have to be assigned a rating of "A" or its equivalent as to investment quality by a national rating agency before such obligations are eligible investments for sinking funds and other public funds. The City has not reviewed the laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

The City has made no investigation of any other laws, rules, regulations or investment criteria that might affect the suitability of the Bonds for any of the above purposes or limit the authority of any of the above persons or entities to purchase or invest in the Bonds.

TAX EXEMPTION

The delivery of the Series 2009A Bonds is subject to an opinion of Andrews Kurth LLP., Houston, Texas and Burney & Foreman, Houston, Texas ("Co-Bond Counsel"), to the effect that interest on the Series 2009A Bonds (i) is excludable from the gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended and in effect on the date of such opinion (the "Code"), of the owners thereof for federal income tax purposes pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (ii) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or corporations. The statutes, regulations, rulings and court decisions on which such opinions are based are subject to change.

In rendering the foregoing opinions, Co-Bond Counsel has relied upon representations and certifications of the City made in a certificate of even date herewith pertaining to the use, expenditure, and investment of the proceeds of the Series 2009A Bonds and has assumed continuing compliance by the City with the provisions of the Master Ordinance and Supplemental Ordinance subsequent to the issuance of the Series 2009A Bonds. The Master Ordinance and the Supplemental Ordinance contain covenants by the City with respect to, among other matters, the use of proceeds of the Series 2009A Bonds and the facilities financed therewith by persons other than state or local governmental units, the manner in which the proceeds of the Series 2009A Bonds are to be invested, the periodic calculation and payment to the United States Treasury of arbitrage "profits" from the investment of the proceeds, and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants would cause interest on the Series 2009A Bonds to be includable in the gross income of the owners thereof from the date of the issuance of the Series 2009A Bonds.

Co-Bond Counsel's opinions are not a guarantee of result and are not binding on the Internal Revenue Service (the "Service"); rather, such opinions represent Co-Bond Counsel's legal judgment based upon its review of existing law to the extent deemed relevant to render such opinions and the representations and covenants referenced above. The Service has an ongoing audit program to determine whether interest on selected state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given as to the likelihood that the Service will commence an audit of the Series 2009A Bonds. If an audit is commenced, under current procedures the Service is likely to treat the City as the "taxpayer," and the owners would have no right to participate in the audit process. In responding to or defending an audit of the tax exempt status of the interest on the Series 2009A Bonds, the City may have different or conflicting interests from the owners. Public awareness of any future audit of the Series 2009A Bonds could adversely affect the value and liquidity of the Series 2009A Bonds during the pendency of the audit, regardless of its ultimate outcome.

Except as described above, Co-Bond Counsel will express no other opinion with respect to any other federal, state, or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Series 2009A Bonds. Prospective purchasers of the Series 2009A Bonds should be aware that the ownership of tax exempt obligations such as the Series 2009A Bonds may result in collateral federal tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

TAX ACCOUNTING TREATMENT OF DISCOUNT AND PREMIUM ON THE BONDS

The initial public offering price to be paid for the Series 2009A Bonds maturing in the years 2029 though 2033, inclusive, (the "Discount Bonds") is less than the amount payable on such Bonds at maturity. An amount

equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount, allocable to the holding period of such Discount Bond by the initial purchaser, will, upon the disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from the gross income of the owners thereof, rather than as taxable gain, for federal income tax purposes on the same terms and conditions as those for other interest on the Bonds described above under "TAX EXEMPTION". Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Bond and generally will be allocated to an initial purchaser in a different amount from the amount of the payment denominated as interest actually received by the initial purchaser during his taxable year.

However, such interest may be required to be taken into account in determining the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax exempt obligations.

In the event of the sale or other taxable disposition of a Discount Bond prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination for federal income tax purposes of accrued interest upon disposition of Discount Bonds and with respect to the state and local tax consequences of owning Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

The initial public offering price of all the Series 2009A Bonds except the Discount Bonds (the "Premium Bonds") is greater than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bond. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, even though no corresponding deduction is allowable. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity. Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium with respect to the Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning Premium Bonds.

LEGAL MATTERS

The delivery of the Bonds is subject to the approving opinions of the Attorney General of the State and of Andrews Kurth LLP, Houston, Texas, and Burney & Foreman, Houston, Texas, Co-Bond Counsel for the City, as to the validity of the issuance of the Series 2009A Bonds under the Constitution and laws of the State. The opinion of Co-Bond Counsel will be based upon an examination of the transcripts of certain proceedings taken by the City incident to the issuance and authorization of the Series 2009A Bonds.

In their capacity as Co-Bond Counsel, Andrews Kurth LLP, Houston, Texas, and Burney & Foreman, Houston, Texas, have reviewed the statements and information contained in the Official Statement under the captions and sub-captions "THE SERIES 2009A BONDS", "SECURITY FOR THE BONDS," "ADDITIONAL BONDS," "CERTAIN COVENANTS AND TERMS OF THE MASTER ORDINANCE," "QUALIFIED HEDGE

AGREEMENTS—Master Ordinance Requirements," "CONTINUING DISCLOSURE OF INFORMATION" (except for the information under the sub-captions "Compliance With Prior Undertakings" as to which no opinion is expressed), and "APPENDIX C" and "APPENDIX D" and Co-Bond Counsel is of the opinion that the statements and information contained therein fairly and accurately reflect the provisions of the Master Ordinance and the Supplemental Ordinance; further, Co-Bond Counsel has reviewed the statements and information contained in the Official Statement under the captions and sub-captions "LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS," and "LEGAL MATTERS" and Co-Bond Counsel is of the opinion that the statements and information contained therein are correct as to matters of law.

Such firms may not have, however, independently verified any of the factual information contained in this Official Statement nor have they conducted an investigation of the affairs of the City or the Combined Utility System for the purpose of passing upon the fairness, accuracy or completeness of this Official Statement. No person is entitled to rely upon such firms' limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the fairness, accuracy or completeness of any of the information contained herein. The fees of Co-Bond Counsel for their services with respect to the Bonds are contingent upon the sale and delivery of the Bonds.

In connection with the issuance of the Series 2009A Bonds, certain legal matters will be passed upon for the City by its Special Disclosure Co-Counsel, Fulbright & Jaworski L.L.P., Houston, Texas, and Edgardo E. Colón, P.C., Houston, Texas and for the Underwriters by their co-counsel, Vinson & Elkins L.L.P, Houston, Texas and Bates & Colman, P.C., Houston, Texas.

Fulbright & Jaworski L.L.P., Andrews Kurth LLP and Burney & Foreman represent the Underwriters from time to time in matters unrelated to the issuance of the Bonds.

The various legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of that expression of professional judgment, of the transaction opined upon, or the future performance of the parties to the transaction. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

INDEPENDENT AUDITORS

The financial statements of the City of Houston, Texas, as of and for the year ended June 30, 2008, included in this Official Statement in APPENDIX A, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report, (which included an explanatory paragraph relating to the implementation of Government Accounting Standards Board Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*) appearing herein which is based on their audit and the reports of other auditors.

CO-FINANCIAL ADVISORS

Coastal Securities, Morgan Keegan & Co., and Estrada Hinojosa & Co., Inc. (the "Co-Financial Advisors") have been retained by the City as its independent financial advisors in connection with the issuance of the Series 2009A Bonds and, in such capacity, have assisted the City in the preparation of documents. The Co-Financial Advisors' fees for services rendered with respect to the Bonds are not contingent upon the sale and delivery of the Series 2009A Bonds.

Although the Co-Financial Advisors have read and participated in the drafting of this Official Statement, such firms have not independently verified any of the information set forth in this Official Statement. The information contained in this Official Statement has been obtained primarily from the City's records and from other sources that are believed to be reliable, including financial records of the City and other entities, and which may be subject to interpretation. No guarantee is made by the Co-Financial Advisors as to the accuracy or completeness of any information herein. No person, therefore, is permitted to rely upon the participation of the Co-Financial Advisors as an implicit or explicit expression of opinion as to such completeness and accuracy.

REGISTRATION, SALE AND DISTRIBUTION

The Series 2009A Bonds have not been registered under the federal Securities Act of 1933, as amended (in reliance upon an exemption therefrom), or the blue sky laws of any jurisdiction. The Master Ordinance and the Supplemental Ordinance have not been qualified under the federal Trust Indenture Act of 1939, as amended (in reliance upon an exemption therefrom).

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THE SECURITIES OR PASSED UPON THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

UNDERWRITING

Piper Jaffray & Co., ("Piper") as representative and on behalf of all of the Underwriters (the "Representative"), has agreed to purchase the Series 2009A Bonds, subject to certain conditions, and has agreed to pay therefor a price of $471,202,185.90 (reflecting the par amount of the Series 2009A Bonds less an original issue discount of $2,278,774.85 and less the Underwriters' discount of $2,569,039.25). The Representative will be obligated to purchase all of the Series 2009A Bonds, if any of the Series 2009A Bonds are purchased.

Piper has entered into an agreement (the "Distribution Agreement") with Advisors Asset Management, Inc. ("AAM") for the distribution of certain municipal securities offerings, including the Series 2009A Bonds, allocated to Piper at the original offering prices. Under the Distribution Agreement, Piper will share with AAM a portion of the fee or commission paid to Piper.

CONTINUING DISCLOSURE OF INFORMATION

In the Supplemental Ordinance, the City has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The City is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the City will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to certain information vendors. This information will be available to securities brokers and others who subscribe to receive the information from the vendors.

Annual Reports

Effective, July 1, 2009, the Municipal Securities Rulemaking Board (the "MSRB") will be the sole information repository and all continuing disclosure documents will therefore be provided to MSRB alone. Access to such information will be made available to the public without charge by the MSRB on its Electronic Municipal Market Access ("EMMA") website.

The City will provide certain updated financial information and operating data to certain information vendors annually. The information to be updated includes all quantitative financial information and operating data with respect to the City of the general type included in this Official Statement as follows: (1) the average daily wastewater flow through and the effective treatment capacity of the Sewer Facilities presented under "THE CITY AND THE SYSTEM — Sewer Facilities — General," (2) the number of "in-City" districts that the City has permitted to be created and the number of "in-City" districts that have been created as presented under "ANNEXATION PROGRAM AND 'IN-CITY' DISTRICTS — In-City Districts," (3) the number of active service connections of the System and the sources of System revenues presented under "SOURCES OF SYSTEM REVENUES — General," (4) the rates charged to various types of customers of the System presented under "RATES — Current Rates," and (5) the amount of the annual charge made by the City's General Fund to the System's Revenue Fund for certain indirect charges incurred by the General Fund on behalf of or as a result of operations of the System as presented under "SYSTEM DEBT AND CHARGES — Indirect Charges Paid by the System and CUS General Purpose Fund Transfers—Indirect Charges" and in APPENDIX A and under the schedules listed in APPENDIX F. The City will update and provide this information within six months after the end of each fiscal year. The City will provide the updated information to each nationally recognized municipal

securities information repository ("NRMSIR") and to any state information depository ("SID") that is designated by the State and approved by the staff of the Commission.

The City may provide updated information in full text or in such other form consistent with the agreement, or may incorporate by reference certain other publicly available documents, as permitted by the Rule. The updated information will include audited financial statements, if the City commissions an audit and it is completed by the required time. If audited financial statements are not provided by that time, the City will provide audited financial statements when and if they become available, but if such audited financial statements are unavailable, the City will provide such financial statements on an unaudited basis within the required time. Any such financial statements will be prepared in accordance with the accounting principles currently in effect as described in APPENDIX A or such other accounting principles as the City may be required to employ from time to time pursuant to state law or regulation.

The City's current fiscal year end is June 30. Accordingly, it must provide updated information by December 31 in each year, unless the City changes its fiscal year. If the City changes its fiscal year, it will notify each NRMSIR and any SID of the change.

Material Event Notices

The City will also provide timely notices of certain events to certain information vendors. The City will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell Bonds: (i) principal and interest payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax exempt status of the Bonds; (vii) modifications to rights of holders of the Bonds; (viii) Bond calls; (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Bonds; and (xi) rating changes. In addition, the City will provide timely notice of any failure by the City to provide information, data, or financial statements in accordance with its agreement described above under "CONTINUING DISCLOSURE OF INFORMATION — Annual Reports." The City will provide each notice described in this paragraph to any SID and to either each NRMSIR or the Municipal Securities Rulemaking Board.

Availability of Information

The City has agreed to provide the foregoing information only to NRMSIRs and any SID. Prior to July 1, 2009, the information will be available to holders of Bonds only if the holders comply with the procedures and pay the charges established by such information vendors or obtain the information through securities brokers who do so. Effective July 1, 2009, all such information must be filed with the MSRB, rather than the current NRMSIRs. The MSRB intends to make the information available to the public without charge through EMMA at ww.emma.msrb.org.

The Municipal Advisory Council of Texas has been designated by the State as a SID and the Commission has determined that it is a qualified SID. The address of the Municipal Advisory Council is 600 West 8th Street, P.O. Box 2177, Austin, Texas 78768-2177, and its telephone number is (512) 476-6947.

Limitations and Amendments

The City has agreed to update information and to provide notices of material events only as described above. The City has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition or prospects or agreed to update any information that is provided, except as described above. The City makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The City disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders of Bonds may seek a writ of mandamus to compel the City to comply with its agreement.

The City may amend its continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status or type of operations of the City, if the agreement, as amended, would have permitted an underwriter to purchase or sell Bonds in the offering made hereby in compliance with the Rule and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or nationally recognized bond counsel determines that the amendment will not materially impair the interests of the beneficial owners of the Bonds. The City may also amend or repeal the agreement if the Commission amends or repeals the applicable provisions of the Rule or a court of final jurisdiction determines that such provisions are invalid, and the City may amend the agreement in its discretion in any other circumstance or manner, but in either case only to the extent that its right to do so would not prevent the Underwriters from purchasing the Bonds in the offering described herein in compliance with the Rule. If the City amends its agreement, it must include with the next financial information and operating data provided in accordance with its agreement described above under "Annual Reports" an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided.

Compliance with Prior Undertakings

The City has complied in all material respects with all continuing disclosure agreements made by it in accordance with the Rule.

FORWARD-LOOKING STATEMENTS

The statements contained in this Official Statement, and in any other information provided by the City, that are not purely historical are forward-looking statements, including statements regarding the expectations of the City, hopes, intentions, or strategies regarding the future. Readers should not place undue reliance on forward-looking statements. All forward-looking statements included in this Official Statement are based on information available to the City on the date thereof, and the City assumes no obligation to update any such forward-looking statements. It is important to note that the actual results of the City and the System could differ materially from those in such forward-looking statements.

The forward-looking statements in this Official Statement are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the City. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate.

GENERAL INFORMATION

The descriptions in this Official Statement do not purport to be complete and all such descriptions or references are qualified in their entirety by reference to the complete form of the Master Ordinance, the Supplemental Ordinance or other documents or source they summarize. Statements made in this Official statement involving estimates or projections, whether or not expressly identified as such, should not be construed to be statements of fact or as representations that such estimates or projections will ever be attained or will approximate actual results. Any summaries or excerpts of constitutional provisions, statutes, ordinances or other documents do not purport to be complete statements of same and are made subject to all of the provisions thereof. Reference should be made to such original sources in all respects. The Series 2009A Bonds are payable solely from the Net Revenues as described herein, and such information is not intended to imply that any other revenues or monies of the City are pledged to pay the principal of and interest on the Series 2009A Bonds.

For additional information with respect to the financial condition of the City, a copy of the June 30, 2008, City Controller's Comprehensive Annual Financial Report of the City of Houston, Texas is available upon written request addressed to the City Controller, P.O. Box 1562, Houston, Texas 77251-1562. A copy of the most recent Quarterly Investment Report is also available upon request from the City Controller. Copies of the Master

Ordinance and the Supplemental Ordinance may be obtained from Anna Russell, City Secretary, City Hall Annex, 900 Bagby, Level P, Room P-101, Houston, Texas, or by mail P.O. Box 1562, Houston, Texas 77251-1562.

This document was approved by the City Council.

* * * * *

APPENDIX A

CITY OF HOUSTON BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY SCHEDULES FOR THE CITY'S COMBINED UTILITY SYSTEM FUND AND THE HOUSTON AREA WATER CORPORATION

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Deloitte

Deloitte & Touche LLP
Suite 4500
1111 Bagby Street
Houston, TX 77002-4196
USA

Tel: +1 713 982 2000
Fax: +1 713 982 2001
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

The Honorable Mayor, Members
of City Council and City Controller
of the City of Houston, Texas:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Houston, Texas (the "City"), as of and for the year ended June 30, 2008, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Houston's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Firefighter's Relief and Retirement Pension Trust Fund, the Municipal Employees' Pension Trust Fund and the Police Officers' Pension Trust Fund, blended component units of the City, which, in aggregate, represent 100% of the assets of the pension trust funds, within the fiduciary funds. In addition we did not audit the financial statements of the Houston Area Water Corporation, a nonmajor business-type enterprise fund, which represents 1% and 0% of the assets and revenues of business-type activities of the City. We also did not audit the financial statements of any governmental (except for the Houston Area Library Automated Network, Lamar Terrace Public Improvement District and Sharpstown Economic Development Authority) or business-type discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for such business-type activities, pension trust funds and governmental and business – type discretely presented component units, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America ("generally accepted auditing standards"). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the City of Houston, Texas, as of June 30, 2008, and the respective changes in financial position and where applicable, cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the City implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which requires the measurement, recognition, and display of other postemployment benefits for the year ended June 30, 2008.

The Management's Discussion and Analysis (pages 3 through 13), Schedule of Budgeted and Actual Revenues and Expenditures of the General Operating Fund (pages 117-121), Pension System Supplementary Information (page 123) and Other Post Employment Benefits Supplementary Information (page 124) are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the City of Houston's management. We and the other auditors 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Houston, Texas' basic financial statements. The Individual Fund Statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. This supplementary information is the responsibility of the City of Houston's management. The Individual Fund Statements have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Deloitte & Touche LLP

December 19, 2008

City of Houston, Texas
Management's Discussion and Analysis
June 30, 2008
(Unaudited)

As management of the City of Houston, we offer readers of the City of Houston's financial statements this narrative overview and analysis of the financial activities of the City of Houston for the fiscal year ended June 30, 2008. Please read this information in conjunction with the basic financial statements that follow this section. The discussion and analysis includes comparative data for 2007. All amounts, unless otherwise indicated, are expressed in millions of dollars.

Financial Highlights

Some of the City's financial highlights for the fiscal year ending June 30, 2008 include:

- The assets of the City of Houston exceeded its liabilities at the close of the most recent fiscal year by $3.891 billion.
- The City's total net assets decreased during the year by $282 million.
- Unrestricted assets are a deficit of $1.163 billion.
- The City of Houston's total expenses were $3.923 billion.
- Program revenues of $1.795 billion reduced the net cost of the City's functions to be financed from the City's general revenues to $2.128 billion.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Houston's basic financial statements. The City of Houston's basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements.

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

The statement of net assets presents information on all of the City of Houston's assets and liabilities, with the difference between the assets and liabilities reported as net assets. Over time, increases and decreases in net assets may serve as a useful indicator of whether the financial position of the City of Houston is improving or deteriorating.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish between functions of the City of Houston that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City of Houston include general government, public safety, public works, health, housing and community development, parks and recreation, and library. The business-type activities of the City of Houston include the airport system, combined utility system, convention & entertainment facilities, and parking facilities management.

The government-wide financial statements include not only the City of Houston itself (known as the primary government), but also legally separate component units for which the City of Houston is financially accountable. With the exception of the Houston Area Water Corporation and the three pension systems, financial information for the component units is reported separately from the financial information presented for the primary government itself. The Houston Area Water Corporation and the pension systems, although also legally separate, function for all practical purposes as departments of the City of Houston, and therefore have been included as an integral part of the primary government.

Fund financial statements. A fund is a group of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Houston, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City of Houston can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide statements, fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. The governmental fund balance sheet (see pgs. 18-19) displays a reconciliation to facilitate this comparison between governmental funds. The reconciliation between the governmental fund statement of revenues, expenditures, and changes in fund balances and governmental activities is provided on a separate schedule (see page 22).

The City of Houston maintains nine individual governmental funds for financial reporting purposes. Information is presented separately in the governmental fund balance sheet (see page 18) and in the governmental fund statement of revenues, expenditures, and changes in fund balances (see page 20) for the general fund, the debt service fund, the capital projects fund and the grants fund, all of which are considered to be major funds. Data from the other funds is combined in the column labeled "Nonmajor Governmental Funds" on both of these statements (see also the separate tab labeled "Governmental Funds" for more information on these funds).

Proprietary funds. The City of Houston maintains two different types of proprietary funds (see statements beginning on page 24): Enterprise funds (see also separate tab of same name) and internal service funds (see also separate tab of same name). Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Houston uses enterprise funds to account for its aviation system, combined utility system (formerly called the water and sewer system), the convention and entertainment facilities and the parking facilities management. The City also includes the Houston Area Water Corporation as a nonmajor proprietary fund. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City of Houston's various functions. The City of Houston uses internal service funds to account for health and benefits and long-term disability activities. Because both of these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the aviation system combined utility system and convention and entertainment facilities, all of which are considered to be major funds for the City of Houston. Conversely, both internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

Fiduciary funds. Fiduciary funds (see separate tab of same name) are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City of Houston's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Notes to the financial statements. The notes (see separate tab of same name) provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning: General fund – budget vs. actual (pgs. 117-120); general budget policies (pg. 122); the City of Houston's progress in funding its obligation to provide pension benefits to its employees (pg. 123); and other post employment benefits (pg. 124).

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Houston, on a government-wide basis, assets exceeded liabilities by $3.891 billion at the close of the most recent fiscal year.

Net Assets
June 30, 2008
(With comparative totals for 2007)
(in millions)

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
Current and other assets	1,054	$ 923	2,143	$ 2,212	$ 3,197	$ 3,135
Capital assets	6,059	5,863	8,435	8,038	14,494	13,901
Total assets	7,113	6,786	10,578	10,250	17,691	17,036
Long-term liabilities	4,089	3,564	8,681	8,356	12,770	11,920
Other liabilities	606	541	424	402	1,030	943
Total liabilities	4,695	4,105	9,105	8,758	13,800	12,863
Net assets						
Invested in capital assets, net of related debt	3,516	3,481	552	745	4,068	4,226
Restricted	213	170	785	642	998	812
Unrestricted (deficit)	(1,310)	(970)	136	105	(1,174)	(865)
Total net assets	$ 2,419	$ 2,681	$ 1,473	$ 1,492	$ 3,892	$ 4,173

By far the largest portion of the City of Houston's net assets (104.2%) reflects its investment in capital assets (e.g., land, building, machinery, equipment and infrastructure); less any related debt used to acquire those assets that is still outstanding. The City of Houston uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City of Houston's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. An additional portion of the City of Houston's net assets (25.7%) represents resources that are subject to external restrictions on how they may be used.

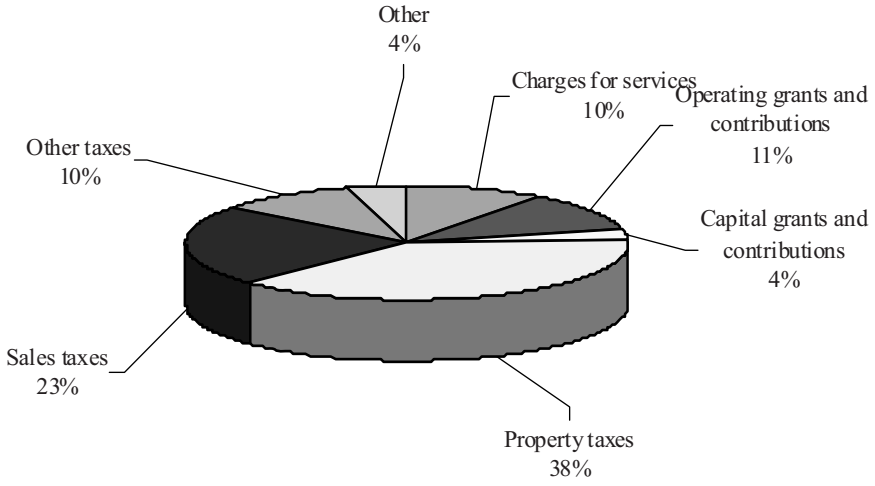
Change in Net Assets
June 30, 2008
(With comparative totals for 2007)
(in millions)

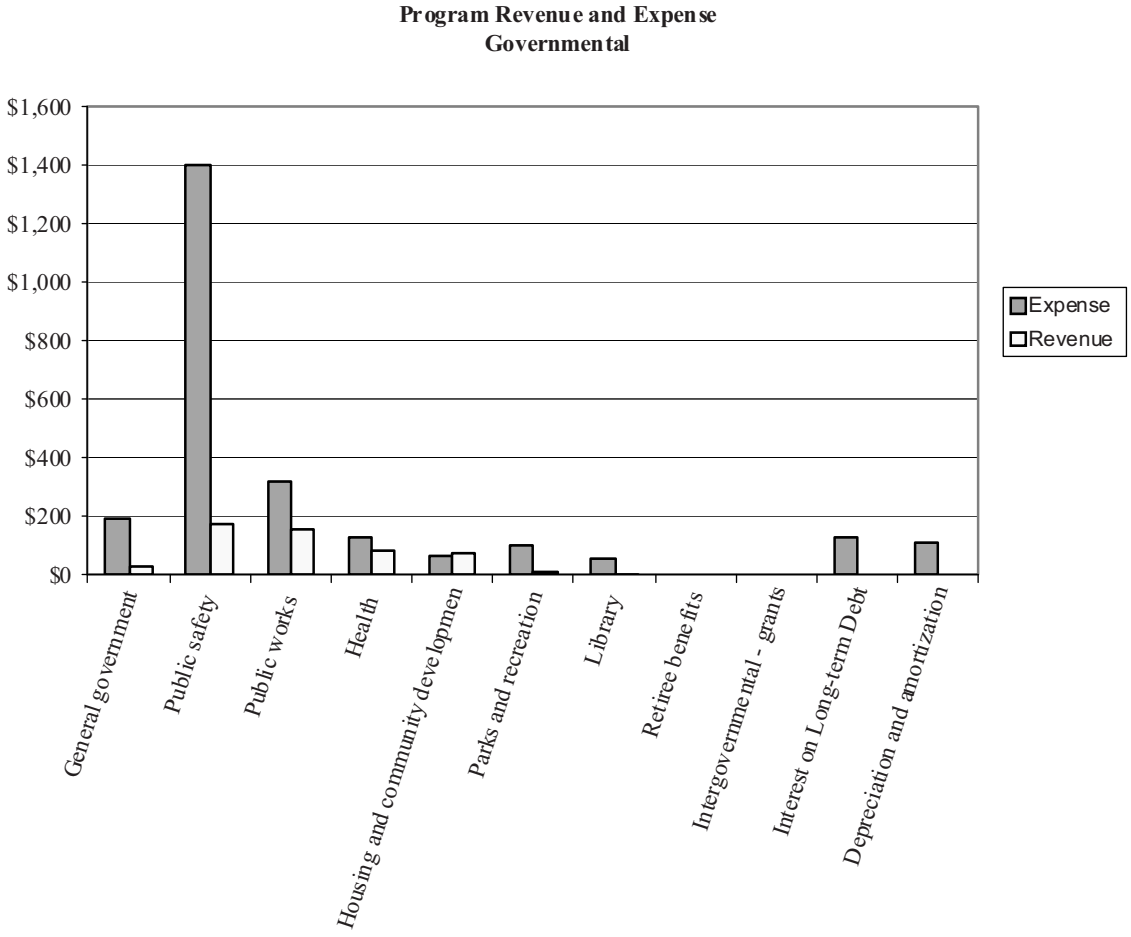
	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
Program Revenues:						
Charges for services	$ 219	$ 220	$ 1,130	$ 1,052	$ 1,349	$ 1,272
Operating grants and contributions	232	247	5	3	237	250
Capital grants and contributions	76	101	133	62	209	163
General revenues:						
Property taxes	830	739	-	-	830	739
Sales taxes	495	461	-	-	495	461
Other taxes	219	216	66	59	285	275
Other	96	55	141	135	237	190
Total revenues	2,167	2,039	1,475	1,311	3,642	3,350
Expenses:						
General government	194	130	-	-	194	130
Public safety	1,401	1,230	-	-	1,401	1,230
Public works	318	275	-	-	318	275
Health	129	102	-	-	129	102
Housing and community development	59	80	-	-	59	80
Parks and recreation	103	85	-	-	103	85
Library	50	39	-	-	50	39
Retiree benefits	-	-	-	-	-	-
Intergovernmental - grants	-	-	-	-	-	-
Interest on Long-term Debt	126	135	-	-	126	135
Depreciation and amortization	110	112	-	-	110	112
Airport System	-	-	459	443	459	443
Convention & Entertainment Facilities	-	-	111	106	111	106
Combined Utility System	-	-	846	820	846	820
Non-Major Enterprise Funds	-	-	17	21	17	21
Total expenses	2,491	2,188	1,433	1,390	3,923	3,578
Change in net assets before contributions, special items and transfers	(324)	(149)	42	(79)	(282)	(228)
Contributions	-	-	-	-	-	-
Special items	-	2	-	5	-	7
Transfers	61	58	(61)	(58)	-	-
Change in net assets	(263)	(89)	(19)	(132)	(282)	(221)
Net assets July 1	2,681	2,772	1,492	1,622	4,173	4,394
Net assets June 30	$ 2,418	$ 2,683	$ 1,473	$ 1,490	$ 3,891	$ 4,173

Governmental activities. Governmental activities decreased the City of Houston's net assets by $262 million. Key elements of this change are as follows:

- Sales tax revenue continued to show improvements during fiscal year 2008 providing a 7.4% increase for the year, from $461 million to $495 million.
- The City's property tax rate was lowered by $.0050 to $0.6375 per $100 assessed value. Property tax revenue increased by $91 million because of the City's rising property values and continued effort in the collection of delinquent taxes.
- The largest decrease in expenses was in the area of Housing and Community Development - $21 million.

Revenue by Source - Governmental Activities

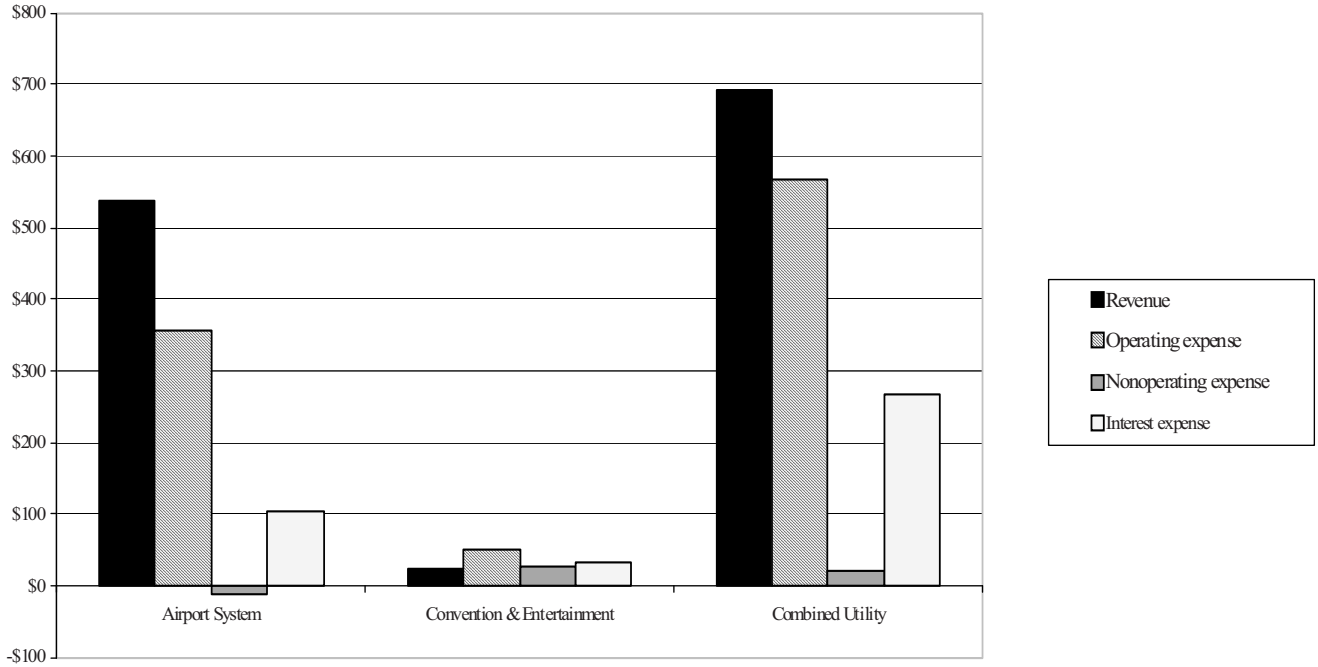




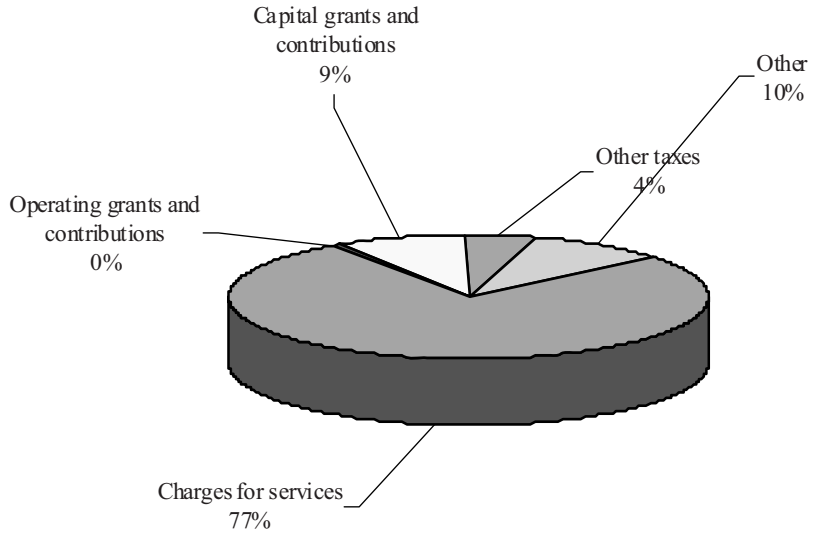
Business-type activities. Business-type activities reduced the City of Houston's net assets by $19 million. Key elements of this change are as follows:

- Airport systems operating expenses were up by 4.1%, from $342 million to $356 million. Operating revenues for these facilities were up by 7.5%, from $416 million to $447 million. Investment income increased by 23.6% from $34 million to $42 million.
- Convention & Entertainment operating expenses were up by 4.4%, from $47 million to $49 million. Operating revenues were up by 8.5%, from $21 million to $22 million. Hotel occupancy taxes increased by 12.8%, from $59 million to $66 million.
- The Combined Utility System operating expenses decreased by 1.1% from $573 million to $567 million. Operating revenues increased by 5.3% from $615 million to $648 million. Investment income was down by 1.6%, from $36 million to $35 million and interest expense was up by 10.4% from $242 million to $268 million.
- The Parking Management Fund, created during the 2008 fiscal year, operating expenses were $4.0 million. Operating revenues were $13 million. Investment income was $121 thousand and there was no interest expense.

Program Revenue & Expense
Business-type



Revenue by Source Business-type



Financial Analysis of the Government's Funds

As noted earlier, the City of Houston uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds (see pgs.18-21 and separate tab of same name). The focus of the City of Houston's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City of Houston's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City of Houston's governmental funds reported combined ending fund balances of $694 million. Approximately 63% of this total amount ($437 million) constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed (1) for capital expenditures ($100 million), (2) to pay debt service ($133 million), or (3) a variety of other restricted purposes ($24 million).

The general fund is the chief operating fund of the City of Houston. At the end of the current fiscal year, unreserved fund balance of the general fund was $309 million, while the total fund balance reached $332 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 19% of total general fund expenditures, while total fund balance represents 21% of that same amount.

Key differences between last year's general fund activity and this year's include:

- $107 million increase in total revenues
- $80 million increase in expenditures
- $28 million increase in proceeds for issuance of debt
- $4 million increase in transfers from other funds
- $34 million increase in transfers to other funds

Interest expenditures for the debt service fund increased by $8 million. The net increase in fund balance was $21.8 million.

The capital projects fund, which is used for the acquisition and/or construction of capital facilities by the City (except those financed by Enterprise Funds), has a fund balance of $100 million. The net increase in fund balance during the current fiscal year was $18 million.

Proprietary funds (see pgs.24-33 and tabs labeled "Enterprise Funds" and "Internal Services Funds"). The City of Houston proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

At the end of the year, unrestricted net assets were $0 for the Airport System, $33 million for Convention and Entertainment, $94 million for the Combined Utility System and $8.8 million for the Combined Non-Major Enterprise Funds. The total increase in net assets for the Airport System, the Convention and Entertainment and Combined Non-Major Enterprise funds were $133 million, $2.2 million and $2.6 million respectively. The Combined Utility System fund experienced a decrease of $156 million. Other factors concerning the finances of these funds have already been addressed in the discussion of the City of Houston's business-type activities.

General Fund Budgetary Highlights

Total revenues were above budget (pgs. 117 - 120), by $56 million. The details of the more significant variances are detailed below:

- $18 million increase in Sales taxes
- $35 million increase in property taxes
- $6 million increase in franchise taxes
- $2 million increase in industrial assessments
- $1 million decrease in other revenues
- $5 million increase in interest
- $9 million decrease in services performed for others
- $2 million increase in other courts fines and forfeits

Total expenditures for the General Fund were $13 million below the final expenditure budget. The details of the more significant variances are detailed below:

- $4 million decrease in public safety expenditures
- $6 million decrease in public works expenditures
- $3 million decrease in total general government expenditures

Capital Asset and Debt Administration

Capital assets (see Note 6, Capital Assets, pages 72–75)**.** The City of Houston's investment in capital assets for its governmental and business-type activities as of June 30, 2008, amounts to $14.5 billion (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, machinery, equipment, storm drainage, streets and bridges. The City of Houston's net investment in capital assets was relatively stable.

Capital Assets
June 30, 2008
(With comparative totals for 2007)
(net of depreciation in millions)

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
Land and right of way	$ 2,029	$ 1,988	$ 423	$ 406	$ 2,452	$ 2,394
Buildings, improvements and equipment	1,396	678	4,423	2,742	5,819	3,420
Plants, lines and rights	-	-	8,175	4,080	8,175	4,080
Construction in progress	413	377	652	810	1,065	1,187
Water rights	-	-	457	-	457	-
Garage rights	-	-	13	-	13	-
Infrastructure Assets	5,096	2,820	-	-	5,096	2,820
Less accumulated depreciation	(2,875)	(2,733)	(5,708)	(5,140)	(8,583)	(7,873)
Total	$ 6,059	$ 3,130	$ 8,435	$ 2,898	$ 14,494	$ 6,028

Major capital asset events during the current fiscal year included the following:

- Business-type activities construction in process balance reflects a $158 million decrease.

More detailed information about the City's capital assets is presented in Note 6 to the financial statements.

Long-term debt (Note 8, pages 76–94). At the end of the current fiscal year, the City of Houston had total bonded debt outstanding of $11.2 billion. The two largest portions of this total are made up of $3 billion comprising debt backed by the full faith and credit of the government and $8.2 billion comprising various enterprise fund revenue bonds which are payable from future revenues of the various operations of those enterprise funds. The City issued $35 million in pension obligations during the fiscal year to reduce the unfunded liability of Houston Police Officers Pension System. The remainder of the City of Houston's debt represents various long-term contracts.

Outstanding Debt
June 30, 2008
(With comparative totals for 2007)
(in millions)

	Governmental Activities		Business-type Activities		Total	
	2008	2007	2008	2007	2008	2007
General obligation bonds and commercial paper	$ 2,586	$ 2,431	$ 283	$ 571	$ 2,869	$ 3,002
Pension notes	472	421	96	96	568	517
Inferior lien contract	-	-	50	54	50	54
Capital lease	-	-	-	-	-	-
Revenue bonds	-	-	7,739	7,245	7,739	7,245
Other borrowings	15	20	-	4	15	24
Total	$ 3,073	$ 2,872	$ 8,168	$ 7,970	$ 11,241	$ 10,842

The City's total debt increased by $399 million or 3.7% during the current fiscal year.

During the current fiscal year, the City issued the following debt:

- $35 million of pension obligations to reduce unfunded accrued actuarial liability.
- $228 million of general obligation debt to refund bonds and commercial paper and to fund capital projects.
- $2.2 billion of combined utility system revenue bonds to refund auction rate securities, fund system projects and refund commercial paper.

Standard & Poor's, Moody's and Fitch's underlying ratings of the City's obligations as of June 30, 2008 are as follows:

	Std & Poor's	Moody's	Fitch's
General Obligation	AA	Aa3	AA-
Water & Sewer System Junior Lien	AA	Aa3	AA-
Combined Utility System First Lien	AA	A1	A+
Houston Airport System	A+	A1	A+
Convention & Entertainment	A-	A3	n/r

State statutes limit the amount of general obligation debt a governmental entity may issue to 10% of its total assessed valuation. The current debt limitation for the City of Houston is $17.4 billion, which is significantly in excess of the City of Houston's outstanding general obligation debt.

Next Year's Budget and Rates

Highlights of the fiscal year 2009 budget are as follows:

- Decreased the property tax rate by 1/2 cent to 63.875 cents per $100 of valuation and increased the homestead exemption for senior citizens.
- The public safety budget was increased to primarily provide resources for Firefighter raises, fuel, three fire cadet classes, seven police cadet classes, demolition of dangerous buildings and cleanup of weeded lots, and a significant increase in fire pension contribution rate.

Request for Information

This financial report is designed to provide a general overview of the City of Houston's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the City Controller, 901 Bagby, 8th Floor, Houston, Texas 77002.

CITY OF HOUSTON, TEXAS
STATEMENT OF NET ASSETS

June 30, 2008
(amounts expressed in thousands)

	Governmental Activities	Business-type Activities	Total	Component Units	
				Governmental	Business-type
Assets					
Current Assets					
Equity in pooled cash and investments	$ 675,917	$ 1,560,868	$ 2,236,785	$ 166,869	$ 77,320
Receivables, net of allowances					
Accounts receivable	84,832	121,675	206,507	16,230	19,783
Contracts receivable	-	-	-	825	-
Hotel occupancy tax receivable	-	18,627	18,627	-	-
Property taxes receivable	42,950	-	42,950	-	-
Sales taxes receivable	86,946	-	86,946	-	-
Mixed beverage taxes receivable	2,759	-	2,759	-	-
Franchise taxes receivable	17,535	-	17,535	-	-
Special assessments receivable	11,288	93	11,381	-	-
Accrued interest and other	-	-	-	707	232
Due from component units	10,084	13,033	23,117	-	-
Internal balances	578	(578)	-	-	-
Due from other governments	80,256	9,448	89,704	-	1,669
Inventory	21,494	9,037	30,531	18,225	312
Prepaid items	1,963	6,659	8,622	112	1,195
Deferred charges for issuance cost	17,128	65,437	82,565	4,143	2,473
Noncurrent assets					
Investments	-	29,230	29,230	34,120	14,253
Other receivables	-	-	-	480	1,289
Due from component units	-	299,350	299,350	-	-
Assessments receivable	-	-	-	4,002	-
Accrued interest receivable	-	-	-	-	55
Receivable and deposits	-	-	-	-	5,916
Other assets					
Other long-term receivables	-	10,058	10,058	75	6,281
Capital Assets					
Land and right-of-way	2,029,053	422,674	2,451,727	84,078	11,488
Buildings, improvements and equipment	1,395,745	4,423,006	5,818,751	18,418	331,554
Plants, lines and rights	-	8,175,389	8,175,389	-	-
Construction in progress	413,613	652,019	1,065,632	-	14,391
Water rights	-	456,915	456,915	-	-
Garage rights	-	13,144	13,144	-	-
Infrastructure assets	5,095,619	-	5,095,619	-	
Less accumulated depreciation and amortization	(2,874,685)	(5,708,227)	(8,582,912)	(8,378)	(63,099)
Total assets	$ 7,113,075	$ 10,577,857	$ 17,690,932	$ 339,906	$ 425,112

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
STATEMENT OF NET ASSETS

June 30, 2008
(amounts expressed in thousands)

	Governmental Activities	Business-type Activities	Total	Component Units	
				Governmental	Business-type
Liabilities					
Accounts payable and accrued expenditures	$ 102,930	$ 100,744	$ 203,674	$ 10,365	$ 10,227
Accrued payroll liabilities	54,443	8,817	63,260	50	707
Accrued interest payable	49,571	83,898	133,469	5,750	3,832
Contracts and retainages payable	113	42,340	42,453	7,809	1,669
Due to component units	-	23,847	23,847	-	-
Due to other governments	24,852	1,196	26,048	3,437	-
Advances and deposits	7,405	39,267	46,672	167	-
Other liabilities	-	-	-	5,791	-
Deferred revenue	36,080	-	36,080	792	1,335
Unearned revenue	-	2,003	2,003	-	-
Advances and deposits	-	-	-	695	-
Noncurrent liabilities					
Due within one year					
Notes payable	-	-	-	5,028	1,338
Revenue bonds payable	-	99,453	99,453	5,940	-
Claims and judgments	21,313	2,517	23,830	-	-
Compensated absences	130,852	12,193	143,045	22	-
Deferred electricity	1,515	3,876	5,391	-	-
Bonds payable	174,868	-	174,868	-	9,275
Inferior lien contracts	-	3,880	3,880	-	-
Other liabilities	1,745	-	1,745	-	355
Due in more than one year					
Due to City of Houston	-	-	-	9,665	300,690
Notes payable	-	-	-	18,691	-
Revenue bonds payable	-	7,639,737	7,639,737	140,145	-
Claims and judgments	121,056	5,200	126,256	-	-
Compensated absences	269,461	19,086	288,547	-	-
Contracts payable	-	188,384	188,384	5,013	-
Bonds payable	1,784,897	-	1,784,897	-	-
Inferior lien contracts	-	45,820	45,820	-	-
Commercial paper	625,950	283,300	909,250	-	-
Arbitrage rebate liability	242	5,182	5,424	-	-
Other long-term liabilities	13,315	-	13,315	-	2,360
Collateralized note payable	258,028	89,700	347,728	-	-
Municipal pension trust liability	203,814	81,648	285,462	-	-
Police officers' pension trust liability	318,567	-	318,567	-	-
Fire fighter's pension trust liability	39,384	-	39,384	-	-
Deferred revenue	-	285,198	285,198	50	15,688
Other post employment benefits	239,622	32,419	272,041		
Pension obligation bonds payable	214,178	5,577	219,755	-	-
Total liabilities	4,694,201	9,105,282	13,799,483	219,410	347,476
Net assets					
Invested in capital assets, net of related debt	3,515,596	551,820	4,067,416	78,053	(35,078)
Restricted net assets					
Restricted for debt service	81,906	83,999	165,905	24,661	31,318
Restricted for renewal and replacement	-	10,200	10,200	-	-
Restricted for maintenance and operations	-	122,409	122,409	8,464	-
Restricted for capital improvement	104,947	568,287	673,234	10,774	-
Other restricted	26,714	-	26,714	60,207	38,949
Unrestricted (deficit)	(1,310,289)	135,860	(1,174,429)	(61,663)	42,447
Total net assets (deficit)	$ 2,418,874	$ 1,472,575	$ 3,891,449	$ 120,496	$ 77,636

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2008
(amounts expressed in thousands)

Functions/Programs	Expenses	Program Revenue: Charges for Services	Program Revenue: Operating Grants and Contributions	Program Revenue: Capital Grants and Contributions
Primary Government				
Governmental activities				
General government	$ 193,928	$ 11,104	$ 18,973	$ -
Public safety	1,400,837	131,221	37,074	-
Public works	317,749	53,375	28,024	76,497
Health	129,197	17,093	65,263	-
Housing and community development	59,182	-	75,087	-
Parks and recreation	102,758	4,683	5,630	-
Library	49,687	1,035	2,152	-
Interest on long-term debt	126,349	-	-	-
Unallocated Depreciation	110,174	-	-	-
Total governmental activities	2,489,861	218,511	232,203	76,497
Business-type activities				
Airport System	459,521	447,176	-	91,175
Convention & Entertainment facilities	110,576	22,306	2,406	-
Combined Utility System	846,368	648,269	2,343	41,075
Nonmajor Enterprise Funds	17,485	13,045	-	478
Total business-type activities	1,433,950	1,130,796	4,749	132,728
Total primary government	$ 3,923,811	$ 1,349,307	$ 236,952	$ 209,225
Component Units				
Governmental	112,342	2,476	45,356	317
Business-type	107,438	97,049	5,678	-
Total component units activities	$ 219,780	$ 99,525	$ 51,034	$ 317

General Revenues:
Taxes
Property taxes levied for general purposes/tax increments
Property taxes levied for debt service
Industrial assessments tax
Sales tax
Franchise tax
Mixed beverage tax
Bingo tax
Hotel occupancy tax
Intergovernmental - grants
Investment earnings
Other
Special Items - gain (loss) on sale of assets
Transfers
Total general revenues, special items, and transfers
Change in net assets
Net assets (deficit) beginning
New component unit & restatement (see Note 16)
Net assets (deficit) ending

(Continued)

Net (Expense) Revenue and Changes in Net Assets					
Primary Government					
Governmental Activities	Business-type Activities	Total	Component Units		
			Governmental	Business-type	
$ (163,851)	$ -	$ (163,851)	$ -	$ -	
(1,232,542)	-	(1,232,542)	-	-	
(159,853)	-	(159,853)	-	-	
(46,841)	-	(46,841)	-	-	
15,905	-	15,905	-	-	
(92,445)	-	(92,445)	-	-	
(46,500)	-	(46,500)	-	-	
(126,349)	-	(126,349)	-	-	
(110,174)	-	(110,174)	-	-	
(1,962,650)	-	(1,962,650)	-	-	
-	78,830	78,830	-	-	
-	(85,864)	(85,864)	-	-	
-	(154,681)	(154,681)	-	-	
-	(3,962)	(3,962)	-	-	
-	(165,677)	(165,677)	-	-	
(1,962,650)	(165,677)	(2,128,327)	-	-	
-	-	-	(64,193)	-	
-	-	-	-	(4,711)	
-	-	-	(64,193)	(4,711)	
606,987	-	606,987	66,477	750	
222,850	-	222,850	-	-	
17,787	-	17,787	-	-	
495,173	-	495,173	-	-	
190,518	-	190,518	-	-	
10,479	-	10,479	-	-	
256	-	256	-	-	
-	66,232	66,232	-	-	
-	-	-	3,739	-	
36,516	96,492	133,008	4,254	4,870	
58,743	44,738	103,481	3,261	10,952	
-	-	-	101	-	
60,824	(60,824)	-	-	-	
1,700,133	146,638	1,846,771	77,832	16,572	
(262,517)	(19,039)	(281,556)	13,639	11,861	
2,681,391	1,491,614	4,173,005	104,403	65,775	
-	-	-	2,454	-	
$ 2,418,874	$ 1,472,575	$ 3,891,449	$ 120,496	$ 77,636	

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
BALANCE SHEET — GOVERNMENTAL FUNDS
June 30, 2008
amounts expressed in thousands

	General	Debt Service	Capital Projects
Assets			
Equity in pooled cash and investments	$ 265,602	$ 131,891	$ 119,657
Receivables, net of allowances			
Accounts receivable	44,160	-	4,598
Property taxes receivable	42,950	-	-
Sales taxes receivable	86,946	-	-
Mixed beverage taxes receivable	2,759	-	-
Franchise taxes receivable	17,535	-	-
Special assessments receivable	11,288	-	-
Due from component units	-	5,779	-
Due from other funds	323	-	-
Due from other governments	3,719	-	23,856
Inventory	20,008	-	-
Prepaid items	1,914	-	49
Total assets	$ 497,204	$ 137,670	$ 148,160
Liabilities and fund balance			
Liabilities			
Accounts payable	39,202	414	42,724
Accrued payroll liabilities	48,896	-	-
Due to other funds	136	-	-
Due to other governments	7,992	-	-
Advances and deposits	4,061	-	489
Deferred electricity	263	-	-
Claims and judgments	2,466	-	-
Compensated absences	2,978	-	-
Other liabilities	-	-	-
Deferred revenue	59,704	5,779	4,604
Total liabilities	165,698	6,193	47,817
Fund balance			
Reserved for imprest cash and prepaids	2,032	-	-
Reserved for equipment acquisitions and other capital outlay	-	-	100,343
Reserved for inventory	20,008	-	-
Reserved for debt service	-	131,477	-
Unreserved	309,466	-	-
Unreserved - Special revenue funds	-	-	-
Total fund balance	331,506	131,477	100,343
Total liabilities and fund balance	$ 497,204	$ 137,670	$ 148,160

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

Assets not available to pay for current-period expenditures are deferred in the funds.

Internal service funds are used by management to charge the cost of health, benefits and workers' compensation to individual funds. The assets and liabilities of the internal service funds are included in the governmental activities in the statement of net assets.

Liabilities, including bonds payable, not due and payable in the current period are not reported in the funds.

Net assets of governmental activities

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

Grants	Nonmajor Governmental Funds	Total
$ 12,504	128,474	$ 658,128
18,110	12,657	79,525
-	-	42,950
-	-	86,946
-	-	2,759
-	-	17,535
-	-	11,288
4,305	-	10,084
-	-	323
48,913	3,768	80,256
1,468	18	21,494
-	-	1,963
$ 85,300	$ 144,917	$ 1,013,251
14,309	6,098	102,747
2,135	3,309	54,340
200	-	336
12,740	4,120	24,852
552	2,303	7,405
-	4	267
-	-	2,466
-	12	2,990
-	113	113
44,575	9,458	124,120
74,511	25,417	319,636
-	-	2,032
-	-	100,343
1,468	18	21,494
1,768	-	133,245
7,553	-	317,019
-	119,482	119,482
10,789	119,500	693,615
$ 85,300	$ 144,917	
		6,059,345
		111,734
		7,331
		(4,453,151)
		$ 2,418,874

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS

STATEMENT OF REVENUES, EXPENDITURES and CHANGES in FUND BALANCES
GOVERNMENTAL FUNDS
For the Fiscal Year Ended June 30, 2008
(With comparative amounts for 2007
amounts expressed in thousands

	General	Debt Service	Capital Projects
Revenues			
Taxes and assessments	$ 1,544,777	$ -	$ -
Licenses and permits	20,841	-	-
Charges for services	91,832	-	-
Intergovernmental - grants	33,395	-	70,562
Fines and forfeits	41,631	-	-
Investment income	18,662	6,182	5,044
Other	13,896	1,707	7,444
Total revenues	1,765,034	7,889	83,050
Expenditures			
Current Expenditures			
General government	132,175	-	-
Public safety	1,015,001	-	-
Public works	208,552	-	-
Health	50,520	-	-
Housing and community development	473	-	-
Parks and recreation	63,562	-	-
Library	34,845	-	-
Retiree benefits	18,506	-	-
Capital outlay	70,223	-	262,432
Debt service principal	1,400	196,371	-
Debt service interest	4,514	125,478	-
Debt service fiscal agent & fees	-	3,700	-
Total expenditures	1,599,771	325,549	262,432
Other financing sources (uses)			
Issuance of debt	130,623	50	256,378
Issuance of refunding debt	-	219,238	-
Bond premium	-	9,004	-
Sale of capital assets	4,879	-	3,276
Transfers in	9,016	336,924	439
Transfers out	(256,374)	-	(62,264)
Payment to escrow agent for refunded bonds	-	(225,740)	
Total other financing sources (uses)	(111,856)	339,476	197,829
Changes in fund balance	53,407	21,816	18,447
Fund balances, July 1	278,099	109,661	81,896
Fund balances, June 30	$ 331,506	$ 131,477	$ 100,343

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

Grants	Nonmajor Governmental Funds	Total
$ -	$ 325	$ 1,545,102
-	41,291	62,132
-	20,722	112,554
181,446	15,314	300,717
-	15,370	57,001
788	5,840	36,516
-	32,488	55,535
182,234	131,350	2,169,557
846	11,316	144,337
38,647	53,874	1,107,522
236	72,645	281,433
57,066	1,244	108,830
76,951	278	77,702
6,470	7,322	77,354
1,710	-	36,555
-	-	18,506
-	-	332,655
-	19	197,790
-	-	129,992
-	-	3,700
181,926	146,698	2,516,376
-	-	387,051
-		219,238
-	-	9,004
417	185	8,757
-	50,281	396,660
(561)	(9,674)	(328,873)
-	-	(225,740)
(144)	40,792	466,097
164	25,444	119,278
10,625	94,056	574,337
$ 10,789	$ 119,500	$ 693,615

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balance of Governmental Funds to the Statement of Activities
For the Fiscal Year Ended June 30, 2008
(amounts expressed in thousands)

Net change in fund balances - total governmental funds	$	119,278
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which the depreciation ($167,630) was less than the increase in capital assets ($363,687) in the current period.		196,057
Revenue in the statement of activities that do not provide current financial resources are deferred as revenues in the funds.		79,546
Generally, governmental funds report revenue when cash is actually received , or is expected 60 days after the close of the fiscal year. Cash received during the period relates to prior periods.		(97,762)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report, as expenditures, the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.		(199,406)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. Governmental funds report payments as expenditures in the period of disbursement. The liquidation of long-term liabilities previously accrued should not be reported in the statement of activities.		(359,706)
Internal service funds are used by management to change the costs of certain activities, such as the cost of health benefits, to individual funds. The net revenue (expense) of the internal service fund is reported with governmental activities.		(524)
Change in net assets of governmental activities	$	(262,517)

* The notes to the basic financial statements are an integral part of this statement *

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CITY OF HOUSTON, TEXAS
PROPRIETARY FUNDS
Statement of Net Assets
June 30, 2008
amounts expressed in thousands

	Business-type Activities - Enterprise Funds		
	Airport System	**Convention & Entertainment**	**Combined Utility**
Assets			
Current Assets			
Equity in pooled cash and investments	$ 828,803	$ 90,873	$ 635,593
Receivables, net of allowances			
Accounts receivable	21,279	2,003	96,728
Hotel occupancy tax receivable	-	18,627	-
Special assessments receivable	-	-	93
Due from component units	-	13,033	-
Due from other funds	34	102	1,544
Due from other governments	3,688	826	4,866
Inventory	2,869	-	6,168
Prepaid items	2,224	708	3,727
Restricted assets			
Investments	7,456	21,774	-
Total current assets	866,353	147,946	748,719
Noncurrent Assets			
Due from component units	-	299,350	-
Due from other funds	-	-	96,859
Deferred charges for issuance cost	5,261	3,439	56,737
Total noncurrent restricted assets	5,261	302,789	153,596
Other assets			
Amount held by other governments	-	-	10,058
Capital assets			
Land	207,439	99,757	115,478
Buildings, improvements and equipment	3,741,652	456,324	204,679
Plants, lines and rights	-	-	8,053,794
Construction in progress	236,090	1,849	413,610
Water rights	-	-	456,915
Garage rights	-	13,144	-
Total capital assets	4,185,181	571,074	9,244,476
Less accumulated depreciation and amortiztion	(1,328,082)	(157,839)	(4,210,358)
Net capital assets	2,857,099	413,235	5,034,118
Total noncurrent assets	2,862,360	716,024	5,197,772
Total assets	$ 3,728,713	$ 863,970	$ 5,946,491

(Continued)

Business-type Activities-Enterprise Funds		Governmental Activities Internal Service Funds
Non-Major Enterprise	Total	
$ 5,599	$ 1,560,868	$ 17,789
1,665	121,675	1
-	18,627	-
-	93	-
-	13,033	-
200	1,880	-
68	9,448	-
-	9,037	-
-	6,659	-
-	29,230	-
7,532	1,770,550	17,790
-	299,350	-
-	96,859	-
-	65,437	-
-	461,646	-
-	10,058	-
		-
-	422,674	-
20,351	4,423,006	-
121,595	8,175,389	-
470	652,019	334
-	456,915	-
-	13,144	-
142,416	14,143,147	334
(11,948)	(5,708,227)	-
130,468	8,434,920	334
130,468	8,906,624	334
$ 138,000	$ 10,677,174	$ 18,124

(Continued)

CITY OF HOUSTON, TEXAS
PROPRIETARY FUNDS
Statement of Net Assets
June 30, 2008
amounts expressed in thousands

	Business-type Activities - Enterprise Funds		
	Airport System	**Convention & Entertainment**	**Combined Utility**
Liabilities			
Current Liabilities			
Accounts payable	$ 6,116	$ 6,669	$ 87,152
Accrued payroll liabilities	3,441	380	4,908
Accrued interest payable	47,686	5,622	30,590
Contracts and retainages payable	24,132	-	18,155
Due to other funds	7	-	316
Due to component units	-	23,847	-
Due to other governments	-	108	1,088
Advances and deposits	1,976	1,052	36,239
Inferior lien contracts	3,880	-	-
Claims and judgments	1,260	-	1,257
Compensated absences	4,343	489	7,252
Deferred electricity note	1,011	255	2,610
Revenue bonds payable	43,050	18,620	37,783
Unearned revenue	1,607	396	-
Total current liabilities from unrestricted assets	138,509	57,438	227,350
Total Current Liabilities	138,509	57,438	227,350
Noncurrent liabilities			
Revenue bonds payable	2,051,120	605,938	4,982,679
Claims and judgments	3,762	160	1,278
Compensated absences	5,514	718	12,783
Contracts payable	-	-	188,384
Inferior lien contracts	45,820	-	-
Commercial paper	83,000	43,800	156,500
Arbitrage rebate	-	340	4,842
Pension note payable	34,800	3,300	51,600
Municipal pension trust liability	30,109	3,156	48,306
Other post employment benefits	11,356	918	19,856
Due to other funds	-	-	-
Unearned revenue	-	9,696	275,502
Pension obligation bonds payable	2,006	189	3,382
Total noncurrent liabilities	2,267,487	668,215	5,745,112
Total liabilities	2,405,996	725,653	5,972,462
Net assets (deficit)			
Invested in capital assets, net of related debt	685,286	63,806	(226,413)
Restricted net assets			
Restricted for debt service	67,847	16,152	-
Restricted for renewal and replacement	10,000	-	-
Restricted for maintenance and operations	41,048	18,502	63,450
Restricted for capital improvements	518,536	6,865	42,886
Unrestricted	-	32,992	94,106
Total net assets (deficit)	$ 1,322,717	$ 138,317	$ (25,971)
Cumulative liability resulting from internal service funds' undercharging proprietary funds			
Net assets of business-type activities			

(Continued)

Business-type Activities-Enterprise Funds		Governmental Activities Internal Service Funds
Non-Major Enterprise	Total	
$ 807	$ 100,744	$ 183
88	8,817	103
-	83,898	-
53	42,340	-
1,544	1,867	-
-	23,847	-
-	1,196	-
-	39,267	-
-	3,880	-
-	2,517	2,816
109	12,193	216
-	3,876	-
-	99,453	-
-	2,003	1,260
2,601	425,898	4,578
2,601	425,898	4,578
-	7,639,737	-
-	5,200	6,430
71	19,086	42
-	188,384	-
-	45,820	-
-	283,300	-
-	5,182	-
-	89,700	-
77	81,648	-
289	32,419	-
96,859	96,859	-
-	285,198	-
-	5,577	-
97,296	8,778,110	6,472
99,897	9,204,008	11,050
29,141	551,820	334
-	83,999	-
200	10,200	-
-	123,000	-
-	568,287	-
8,762	135,860	6,740
$ 38,103	1,473,166	$ 7,074
	(591)	
	$ 1,472,575	

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
PROPRIETARY FUNDS
Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Fiscal Year Ended June 30, 2008
amounts expressed in thousands

	Business-type Activities - Enterprise Funds		
	Airport System	**Convention & Entertainment**	**Combined Utility**
Operating Revenues			
Landing area fees	$ 99,017	$ -	$ -
Terminal space rentals	211,786	-	-
Parking	72,958	9,774	
Concession	58,789	5,308	-
Other	4,626	-	-
Rental	-	7,224	-
Water/Sewer Billing	-	-	648,269
Health benefit premiums	-	-	-
Total operating revenue	447,176	22,306	648,269
Operating Expenses			
Administrative costs	-	-	-
Claims Costs	-	-	-
Maintenance and operating	229,551	37,276	346,665
Depreciation and amortization	125,951	12,084	220,190
Total operating expenses	355,502	49,360	566,855
Operating income (loss)	91,674	(27,054)	81,414
Nonoperating revenue (expenses)			
Investment income	41,694	19,186	35,435
Hotel occupancy tax	-	66,232	-
Other revenue	514	1,077	31,517
Gain (Loss) on disposal of assets	37	1	(12,009)
Other expenses	11,608	(28,066)	-
Interest on long-term debt	(104,056)	(33,150)	(267,504)
Contributions	-	2,406	2,343
Total nonoperating revenues (expenses)	(50,203)	27,686	(210,218)
Income (loss) before capital contributions and transfers	41,471	632	(128,804)
Capital contributions	91,175	881	42,862
Transfers in	-	1,304	1,020
Transfers out	-	(593)	(71,167)
Total transfers	-	711	(70,147)
Change in net assets	132,646	2,224	(156,089)
Liability resulting from internal service fund's undercharging proprietary funds			
Net change			
Total net assets (deficit), July 1	1,190,071	136,093	130,118
Total net assets (deficit), June 30	$ 1,322,717	$ 138,317	$ (25,971)
Cumulative liability resulting from internal service funds' undercharging proprietary funds			
Total net assets business-type activities			

(Continued)

* The notes to the basic financial statement are an integral part of this statement *

Business-type Activities Enterprise Funds		Governmental Activities Internal Service Funds
Non-Major Enterprise	Total	
$ -	$ 99,017	$ -
-	211,786	-
13,045	95,777	-
-	64,097	-
-	4,626	-
-	7,224	-
-	648,269	-
-	-	266,475
13,045	1,130,796	266,475
3,727	3,727	3,027
-	-	265,254
8,778	622,270	-
4,679	362,904	-
17,184	988,901	268,281
(4,139)	141,895	(1,806)
177	96,492	1,282
-	66,232	-
457	33,565	-
-	(11,971)	-
-	(16,458)	-
(301)	(405,011)	-
478	5,227	-
811	(231,924)	1,282
(3,328)	(90,029)	(524)
4,295	139,213	-
8,823	11,147	-
(7,174)	(78,934)	-
1,649	(67,787)	-
2,616	(18,603)	(524)
	(436)	
	(19,039)	
35,487	1,491,769	7,598
$ 38,103	1,472,730	$ 7,074
	(155)	
	$ 1,472,575	

* The notes to the basic financial statement are an integral part of this statement *

CITY OF HOUSTON, TEXAS
PROPRIETARY FUNDS
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008
amounts expressed in thousands

	Business-type Activities - Enterprise Funds		
	Airport System	**Convention & Entertainment**	**Combined Utility**
Cash flows from operating activities			
Receipts from customers	$ 437,312	$ 20,621	$ 623,236
Payments to employees	(84,338)	(9,029)	(127,065)
Payments to suppliers	(91,173)	(26,578)	(123,271)
Internal activity-payments (to) from other funds	(36,833)	(784)	(17,032)
Claims paid	(1,260)	(31)	(459)
Due from other governments	-	29	-
Other revenues	571	1,077	31,517
Other expenses	-	(1,962)	-
Net cash provided by (used in) operating activities	224,279	(16,657)	386,926
Cash flows from investing activities			
Interest income on investments	41,863	19,186	35,435
Purchase of investments	(26,927)	-	-
Proceeds from sale of investments	26,485	-	-
Gain(loss) on sale of nonpooled stock	(169)	-	-
Net cash provided by (used in) investing activities	41,252	19,186	35,435
Cash flows from capital and related financing activities			
Retirement of revenue bonds	(34,500)	(17,540)	(107,416)
Refunding of revenue bonds	(247,858)	-	-
Retirement of commercial paper	(43,000)		-
Proceeds (uses of cash) from issuance of revenue bonds	290,863	-	131,436
Proceeds from issuance of commercial paper	31,000	8,300	220,000
Passenger facilities charges	11,608	-	-
Interest expense on debt	(112,852)	(23,926)	(207,739)
Retirement of inferior lien contract	(3,660)	-	-
Proceeds from disposition of assets	-	-	14,178
Advances and deposits on construction	17	-	-
Contributed capital	84,417	-	112,407
Deferred bond issuance costs	-	-	(17,139)
Acquisition of property, plant and equipment	(131,710)	(2,852)	(385,352)
Retirement of contractual obligations	-	-	(122,788)
Net cash provided by (used in) capital and related financing activities	(155,675)	(36,018)	(362,413)

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

Business-type Activities - Enterprise Funds		Governmental Activities
Non-Major Enterprise	Total	Internal Service Funds
12,796	$ 1,093,965	$ 266,472
(2,184)	(222,616)	(2,328)
(11,274)	(252,296)	(349)
10,595	(44,054)	(29)
-	(1,750)	(265,016)
-	29	-
457	33,622	-
-	(1,962)	-
10,390	604,938	(1,250)
177	96,661	1,282
-	(26,927)	-
4,215	30,700	-
-	(169)	-
4,392	100,265	1,282
(1,237)	(160,693)	-
-	(247,858)	-
	(43,000)	
-	422,299	-
-	259,300	-
-	11,608	
(1,100)	(345,617)	-
-	(3,660)	-
-	14,178	-
707	724	-
-	196,824	-
-	(17,139)	-
(380)	(520,294)	(334)
-	(122,788)	-
(2,010)	(556,116)	(334)

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
PROPRIETARY FUNDS
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008
amounts expressed in thousands

	Business-type Activities - Enterprise Funds		
	Airport System	**Convention & Entertainment**	**Combined Utility**
Cash flows from noncapital financing activities			
Promotional contract paid from hotel occupancy tax revenues to component units	-	(26,104)	-
Interest expense electrical contract	(50)	-	-
Interest expense on pension obligation bonds	(106)	(10)	-
Interest expense collateralized note	(2,958)	(281)	-
Deferred charges on future debt issuance	(28)	-	-
Payments from Hotel Corporation	-	2,622	-
Hotel occupancy tax revenue	-	64,474	-
Transfers to debt service fund	-	-	(25,804)
Transfers to other funds	-	711	(44,342)
Net cash provided by (used in) noncapital financing activities	(3,142)	41,412	(70,146)
Net increase (decrease) in cash and cash equivalents	106,714	7,923	(10,198)
Cash and cash equivalents, July 1	722,089	82,950	645,791
Cash and cash equivalents, June 30	$ 828,803	$ 90,873	$ 635,593
Non cash transactions			
Amortization expense	-	-	13,013
Unrealized gain (loss) on investments	7,573	812	3,820
Capital additions included in liabilities	(5,023)	-	38,524
Contributions of capital assets	(5,486)	881	42,863
Capitalize interest expense	12,071	-	18,566
Gain (loss) on disposal of assets	(37)	-	-
Total non cash transactions	$ 9,098	$ 1,693	$ 116,786
Reconciliation of operating income (loss) to net cash provided (used) by operating activities			
Operating income (loss)	$ 91,674	$ (27,054)	$ 81,414
Depreciation and amortization	125,952	12,084	220,190
Other post employment benefits	11,356	918	19,856
Other revenues	571	1,077	31,516
Other expenses	-	(1,962)	-
Changes in assets and liabilities			
Accounts receivable and prepaids	(1,817)	(777)	(28,704)
Arbitrage rebate	-	-	2,415
Due from other funds	(28)	(26)	-
Due from other governments	-	-	4,511
Inventory and prepaid insurance	639	(44)	(1,151)
Accounts payable	(975)	(444)	48,426
Accrued payroll liabilities	681	83	755
Due to other funds	(602)	-	316
Due to other governments	-	29	-
Advances and deposits	(8,047)	(215)	3,671
Construction and retainages payable	-	-	-
Claims and judgments-workers' compensation	905	(131)	28
Compensated absences	1,373	342	2,457
Pension Obligation payable	2,597	289	3,679
Deferred revenue	-	(931)	-
Other long-term liabilities	-	105	(2,453)
Net cash provided by (used in) operating activities	$ 224,279	$ (16,657)	$ 386,926

(Continued)

* The notes to the basic financial statements are an integral part of this statement *

Business-type Activities - Enterprise Funds		Governmental Activities
Non-Major Enterprise	Total	Internal Service Funds
-	(26,104)	-
-	(50)	-
-	(116)	-
-	(3,239)	-
-	(28)	-
(7,174)	(4,552)	-
-	64,474	-
-	(25,804)	-
-	(43,631)	-
(7,174)	(39,050)	-
5,599	110,037	(302)
-	1,450,830	18,091
$ 5,599	$ 1,560,867	$ 17,789
(4)	13,009	-
17	12,222	-
-	33,501	-
-	38,258	-
4,295	34,932	-
-	(37)	-
$ 4,308	$ 131,885	$ -
$ (4,139)	$ 141,895	$ (1,806)
4,680	362,906	-
-	32,130	-
8,588	41,752	-
-	(1,962)	-
1,523	(29,775)	(2)
-	2,415	-
-	(54)	-
-	4,511	(1,602)
-	(556)	-
(895)	46,112	121
88	1,607	26
-	(286)	-
-	29	1,602
-	(4,591)	10
-	-	-
-	802	260
-	4,172	37
180	6,745	-
-	(931)	104
365	(1,983)	-
$ 10,390	$ 604,938	$ (1,250)

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
June 30, 2008
amounts expressed in thousands

	Pension Trust Funds	Agency Funds
Assets		
Equity in pooled cash and investments	$ 5,886	$ 17,141
Investments		
U.S. government and agency securities	46,189	-
Corporate bonds	88,482	-
Other fixed income securities	1,888,289	-
Commingled equity funds	537,365	-
Common and preferred stock	3,137,672	-
Real estate and partnerships	2,286,790	-
Short-term investment funds	226,219	-
Invested securities lending collateral	829,714	-
Receivables, net of allowances		
Accounts receivable	26,365	121
Contributions	5,007	-
Accrued interest and other	436,415	-
Other Assets	52,707	-
Land	483	-
Building	6,916	-
Total assets	9,574,499	17,262
Liabilities		
Accounts payable	101,885	17,129
Advances and deposits	-	133
Security lending collateral	829,714	-
Foreign funds contracts payable	18,772	-
Other liabilities	4,638	-
Total liabilities	955,009	$ 17,262
Net assets		
Held in trust for pension benefits and other purposes	$ 8,619,490	

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON, TEXAS
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
PENSION TRUST FUNDS
For the Year Ended June 30, 2008
amounts expressed in thousands

	2008
Additions	
Contributions:	
City of Houston	$ 190,323
Plan members	72,610
Total Contributions	262,933
Investment earnings	
Interest and dividends	245,769
Net decrease in the fair value of investments	(69,593)
Total investment earnings	176,176
Less investment expense	(55,321)
Net investment earnings	120,855
Total additions	383,788
Deductions	
Benefits	414,695
Refund of contributions	2,607
Administrative expense	17,341
Total deductions	434,643
Change in net assets	(50,855)
Total net assets, July 1	8,670,345
Total net assets, June 30	$ 8,619,490

* The notes to the basic financial statements are an integral part of this statement *

CITY OF HOUSTON
TEXAS

CITY OF HOUSTON, TEXAS
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2008

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CITY OF HOUSTON
TEXAS

Note 1: Summary of Significant Accounting Policies

The City of Houston, Texas ("City") was incorporated under the laws of the Republic of Texas in 1837 and again under the laws of the State of Texas in 1905. The City operates under a Home Rule Charter with a Mayor-Council form of government and provides the following services as authorized or required by its charter: public safety (police and fire), highways and streets, sanitation, water, airports, health services, culture-recreation, storm drainage, solid waste disposal, planning and inspection, civil defense, public improvements, and general administrative services, including pension and other benefits for its employees.

The financial statements presented in this report conform to the reporting requirements of the Governmental Accounting Standards Board ("GASB"), which establishes combined statements as the required reporting level for governmental entities that present financial statements in accordance with generally accepted accounting principles.

The significant accounting policies of the City are as follows:

A. Principles Used in Determining the Reporting Entity for Financial Reporting Purposes

The accompanying financial statements include financial statements for related organizations in accordance with GASB Statement No.14, *The Financial Reporting Entity* and GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units.* Organizations are included if they are financially accountable to the City, or the nature and significance of their relationship with the City are such that exclusion would cause the financial statements to be misleading or incomplete. Inclusion is determined on the basis of the City's ability to exercise significant influence**.** Significant influence or accountability is based primarily on its operational or financial relationship with the City (as distinct from legal relationship).

The City is financially accountable if it appoints a voting majority of an organization's governing body and is able to impose its will on that organization, or there is a potential for the organization to provide specific financial benefits to or impose specific financial burdens on the City. Blended component units (although legally separate entities) are, in substance, part of the City's operations. Blended component units provide services exclusively or almost exclusively for the City. Both governmental and business-type discretely presented component units are reported in separate columns in the government-wide financial statements to emphasize their legal separateness from the City.

B. Basis of Presentation - Financial Reporting Entity

1. Component Units

Most component units of the City issue separately audited financial statements. Component units are reported in the City's Comprehensive Annual Financial Report ("CAFR") as shown in the following tables. Additional information is available from the addresses shown.

There are three specific tests for determining whether a particular legally separate entity is a component unit of a primary government's financial reporting entity. Those tests involve 1) appointment of the unit's governing board (accompanied by either the potential imposition of will or ongoing financial benefit/burden), 2) fiscal dependence on the primary government, and 3) the potential that exclusion would result in misleading financial reporting. For this last test, special attention must be paid 1) to certain special financing authorities and 2) to the nature and significance of a legally separate, tax-exempt entity's relationship with the primary government and its component units.

Following are the City's blended component units:

Blended Component Units Reported with the Primary Government	Brief Description of Activities, Relationship to the City and Key Inclusion Criteria
Houston Area Water Corporation ***611 Walker, Suite 2100*** ***Houston, TX 77002***	The Corporation is organized for the purpose of: providing treated, potable water to the City of Houston for sale to customers located wholly or partially in Area Three of the Harris-Galveston Coastal Subsidence District, and; aiding and assisting the City of Houston in performing its obligations with respect to a regional groundwater reduction plan by, among other things, constructing, improving, equipping, repairing, operating and maintaining water treatment and distribution facilities and purchasing and selling water in connection therewith. The City appoints its Board and a financial benefit/burden relationship exists, allowing the city to impose its will. In addition, there is a fiscal dependency on the City. **Reporting Fund:** Business Type, Non-Major

Blended Component Units Reported with the Primary Government	Brief Description of Activities, Relationship to the City and Key Inclusion Criteria
Houston Firefighters' Relief & Retirement Fund ***4225 Interwood North Parkway*** ***Houston, TX 77032***	Responsible for administration, management, and operation of the pension system solely for active and retired City of Houston firefighters. One member of the Board is either the Mayor or an appointed representative, five members are elected by active firefighters, one member is elected by retired firefighters, two members are citizen representatives, and one member is the City Treasurer. There is a fiscal dependency on the City, and there is the potential that exclusion would result in misleading financial reporting. **Reporting Fund:** Houston Firefighters' Relief and Retirement Pension Trust Fund.
Houston Municipal Employee's Pension System ***1111 Bagby, Suite 2450*** ***Houston, TX 77002***	Responsible for administration, management, and operation of the pension system solely for active and retired municipal (non-classified) employees of the City. One member of the Board is appointed by the Mayor, one member of the Board is appointed by the City Controller, four are elected by active employees, two are elected by retirees, one is appointed by the elected trustees and two are appointed by the governing body of the City. There is a fiscal dependency on the City, and there is the potential that exclusion would result in misleading financial reporting. **Reporting Fund:** Houston Municipal Employee's Pension Trust Fund.
Houston Police Officer's Pension System ***602 Sawyer, Suite 300*** ***Houston, TX 77007***	Responsible for administration, management, and operation of the pension system solely for active and retired police officers of the City. One member of the Board is appointed by the Mayor, three are elected by employees, two are elected by retirees, and one is the City Treasurer. There is a fiscal dependency on the City, and there is the potential that exclusion would result in misleading financial reporting. **Reporting Fund:** Police Officer's Pension Trust Fund.

Following are the City's discretely presented business type component units:

Discretely Reported Component Units	Brief Description of Activities, Relationship to City, and Key Inclusion Criteria
Houston Convention Center Hotel Corporation ("HCCHC") ***c/o George R. Brown*** ***Avenida De Las Americas*** ***Houston, TX 77010***	Local government corporation created by the City in accordance with the Texas Transportation Corporation Act and Chapter 394 of the Texas Local Government Code authorized to construct, improve, enlarge, equip, repair, operate and maintain a hotel in downtown Houston within one thousand feet of the George R. Brown Convention Center. Board members are appointed by the Mayor and confirmed by City Council and a financial benefit/burden relationship exists, allowing the City to impose its will.
Houston Housing Finance Corporation ("HHFC") ***9545 Katy Freeway, Suite 105.*** ***Houston, TX 77024***	Non-profit corporation incorporated by the City in accordance with the Texas Housing Finance Corporation Act to finance residential mortgage loans to low or moderate-income persons through the sale of revenue bonds collateralized by the mortgage loans. The Board is nominated by the Mayor and confirmed by City Council. The City has financial accountability because it appoints a voting majority of the Board and a financial benefit/burden relationship exists, allowing the City to impose its will.
Houston Zoo, Inc. ***1513 N. MacGregor*** ***Houston, TX 77030***	Houston Zoo, Inc. (HZI) is a 501(c)(3) corporation and has a contract with Houston Zoo Development Corp to operate the Zoo. The Mayor may appoint up to 20% of the Board of Directors of HZI. Houston Zoo Development Corporation (HZDC) is a local government corporation that leases the zoo from the City. The lease provides for the City to make payments in support of capital and operating expenses over the lease term, which it makes available to HZI. There is a fiscal dependency on the City, and there is the potential that exclusion would result in misleading financial reporting.

Following are the City's discretely presented governmental fund component units.

Discretely Reported Component Units	Brief Description of Activities, Relationship to City, and Key Inclusion Criteria
City Park Redevelopment Authority ***c/o Hawes Hill Calderon LLP*** ***P.O. Box 22167*** ***Houston, Texas 77227***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the City Park Tax Increment Reinvestment Zone Board in the redevelopment of a neighborhood northwest of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by the City Council and a financial benefit/burden relationship exists, allowing the City to impose its will. In addition, there is a fiscal dependence on the City.
East Downtown Redevelopment Authority ***c/o Hawes Hill Calderon LLP*** ***P.O. Box 22167*** ***Houston, Texas 77227***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the East Downtown Tax Increment Zone Board in the redevelopment of a blighted neighborhood east of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and a financial benefit/burden relationship exists, allowing the City to impose its will. In addition, there is a fiscal dependence on the City.
Fifth Ward Redevelopment Authority ***c/o Hawes Hill Calderon LLP*** ***P.O. Box 22167*** ***Houston, Texas 77227***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Fifth Ward Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood adjacent to Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and a financial benefit/burden relationship exists, allowing the City to impose its will. The City has investment authority for the Zone's assets.
Fourth Ward Redevelopment Authority ***c/o Zinetta Burney, General Counsel*** ***Burney & Foreman*** ***5445 Almeda Suite 400*** ***Houston, Texas 77004***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Fourth Ward Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood adjacent to Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and a financial benefit/burden relationship exists, allowing the City to impose its will. The City has investment authority for the Zone's assets.
Greater Greenspoint Redevelopment Authority ***16945 Northchase Dr, Suite 1900*** ***Houston, Texas 77060***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Greater Greenspoint Tax Increment Reinvestment Zone Board in the redevelopment of the Greenspoint Mall and blighted adjacent neighborhood in North Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and a financial benefit/burden relationship exists, allowing the City to impose its will.
Greater Houston Convention and Visitors Bureau ***901 Bagby, Suite 1005*** ***Houston, Texas 77002***	A non-profit organization established in 1963 and funded by both private sector memberships and a portion of the hotel bed tax. Their mission is to improve the economy of Greater Houston by attracting conventions, tourists, film projects and international government officials to the area through sales and marketing efforts. The City has financial accountability because it must approve the members of the board of directors and a financial benefit/burden relationship exists, allowing the City to impose its will. In addition, there is a fiscal dependence on the City.
Gulfgate Redevelopment Authority ***c/o Knudson & Associates*** ***8588 Katy Freeway, Suite 441*** ***Houston, Texas 77024***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Gulfgate Tax Increment Reinvestment Zone Board in the redevelopment of the Gulfgate Mall and blighted adjacent neighborhood southeast of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and a financial benefit/burden relationship exists allowing the City to impose its will.

Discretely Reported Component Units	Brief Description of Activities, Relationship to City, and Key Inclusion Criteria
HALAN – Houston Area Library Automated Network Board ***Houston Central Library*** ***500 McKinney*** ***Houston, TX 77002***	Provides review and guidance to the operation, funding and development of the Houston Area Library Automated Network, which provides library services to Houston and surrounding communities. Three members are appointed by City Council, two by the County, and one elected by the smaller libraries. The City does not appoint a voting majority, but is financially accountable for this organization because HALAN is fiscally dependent on the City for all revenues, allowing the City the ability to impose its will.
Houston Arts Alliance ***3201 Allen Parkway, Suite 250*** ***Houston, TX 77019***	Non-profit organization that is the officially designated arts agency of the City. The City does not appoint a voting majority, but is financially accountable because the alliance is fiscally dependent on the revenues provided from a portion of hotel occupancy tax, which is levied by the City. This fiscal dependency allows the City to impose its will.
Houston Business Development Inc. ***5330 Griggs Road*** ***Houston, Texas 77021***	A non-profit organization established by the City of Houston in 1986, providing loans and management counseling to small and emerging businesses, and encouraging the expansion of commercial and industrial enterprises. The City has financial accountability because the voting majority of the board members are appointed by City Council and the operations provide financial benefits to the City. Its primary source of funding is through community Development Block Grants and there is the potential that exclusion would result in misleading financial reporting.
Houston Downtown Park Corporation ***2217 Welch*** ***Houston, TX 77019***	Local government corporation created by the City in 2004 in accordance with Chapter 431 of the Texas Transportation Corporation Act to aid and act on behalf of the City to accomplish the City's governmental purpose of providing for the acquisition, development, operation, and maintenance of a new public park, open space and related amenities and facilities to provide recreational, educational and tourism opportunities within, and beautification of the Central Business District of the City. Additionally, the corporation maintains an enterprise fund to account for the activities of the Discovery Green Parking Garage. Board members are appointed by the City and a financial benefit/burden relationship exists, allowing the City to impose its will. There is the potential that exclusion would result in misleading financial reporting.
Houston Parks Board ***2001 Kirby Dr., Suite 814*** Houston, Texas 77019	Solicits and manages funds raised privately for park acquisitions and advises the Mayor and City Council on park acquisitions and improvements, which provide a direct benefit to the City. Board members are nominated by the Mayor and confirmed by City Council, allowing the City to impose its will. Upon dissolution, all assets revert to the City. There is a potential that exclusion would result in misleading financial reporting.
Houston Public Library Foundation (formerly Houston Library Board) ***Houston Central Library*** ***500 McKinney*** ***Houston, TX 77002***	Solicits and manages funds raised privately for library improvements. Advises the Mayor and City Council on additions and improvements to the library system that provide a direct benefit to the City. Board members are nominated by the Mayor and confirmed by City Council, allowing the City to impose its will. There is a potential that exclusion would result in misleading financial reporting.
Lamar Terrace Public Improvement District ***City of Houston*** ***Box 1562*** ***Houston, Texas 77251***	Special district organized under state statute to redevelop a blighted neighborhood in Southwest Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City, allowing the City to impose its will.
Land Assemblage Redevelopment Authority ***City of Houston*** ***Box 1562*** Houston, Texas 77251	The Land Assemblage Redevelopment Authority (LARA) is a 13-member board appointed by the Mayor, City Council, Harris County and the Houston Independent School District. The LARA Authority is organized for the purpose of aiding, assisting and acting on behalf of the City in the performance of its governmental functions to promote the common good and general welfare of the City and in undertaking and completing one or more projects, as may be defined or determined by the City Council of the City. The City has financial accountability because the voting majority of the board members are nominated by City Council, allowing the City to impose its will, and the operations provide financial benefits to the City.

Discretely Reported Component Units	Brief Description of Activities, Relationship to City, and Key Inclusion Criteria
Main Street Market Square Redevelopment Authority ***909 Fannin St., Suite 1650*** ***Houston, Texas 77002***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Main St./Market Square Tax Increment Reinvestment Zone Board in the redevelopment of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Memorial City Redevelopment Authority ***c/o Knudson & Associates*** ***8588 Katy Freeway, Suite 441*** ***Houston, Texas 77024***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Memorial City Tax Increment Reinvestment Zone Board in the redevelopment of the Memorial City Mall and Town & Country Mall areas, west of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Memorial-Heights Redevelopment Authority ***c/o Knudson & Associates*** ***12 Greenway Plaza, Suite 1500 Houston, Texas 77046-1287***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Memorial Heights Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood adjacent to Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Midtown Redevelopment Authority ***3401 Louisiana, Suite 355*** ***Bienville Building*** ***Houston, Texas 77002***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Midtown Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood south of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Miller Theatre Advisory Board, Inc. ***P.O. Box 6627*** ***Houston, Texas 77266-6627***	Miller Theatre Advisory Board, Inc. (the Board) is a Texas nonprofit corporation with the primary objective to advance the educational and cultural interests of the people of Houston through a continuing program of artistic, educational, and cultural events at the Miller Outdoor Theatre which is owned by the City of Houston. This is accomplished by various artistic and performing groups providing programs at the Theatre supported by grants awarded by the Board. The City has financial accountability because the directors are appointed by the mayor of the City of Houston and approved by City Council, and its primary source of funding is from Hotel Occupancy taxes which the Board receives from the City through the Houston Arts Alliance.
Old Sixth Ward Redevelopment Authority ***c/o Parke Patterson Consultants, Inc.*** ***P.O. Box 994*** ***Sugar Land, Texas 77487***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Old Sixth Ward Tax Increment Reinvestment Zone Board in the redevelopment of a neighborhood adjacent to Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council, the operations provide financial benefits to the City, the City has investment authority for the Zone's assets.
OST/Almeda Corridors Redevelopment Authority ***5445 Almeda Suite 502*** ***Houston, Texas 77004***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the OST/Almeda Corridors Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood south of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Saint George Place Redevelopment Authority ***c/o Hawes Hill Calderon LLP*** ***P.O. Box 22167*** ***Houston, Texas 77227-2167***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the St. George Place Tax Increment Reinvestment Zone Board in the redevelopment of a blighted neighborhood in southwest Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council. The operations provide financial benefits to the City and the City has investment authority for the Zone's assets.

Discretely Reported Component Units	Brief Description of Activities, Relationship to City, and Key Inclusion Criteria
Sharpstown Economic Development Authority ***c/o Hawes, Hill & Associates*** ***P.O. Box 22167*** ***Houston, Texas 77227-2167***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to manage and administer the Sharpstown Public Improvement District (the "PID"), created under Chapter 372 of the Local Government Code. The City has financial accountability because the voting majority of the board members are nominated by City Council, allowing the City to impose its will, and the operations provide financial benefits to the City.
South Post Oak Redevelopment Authority ***c/o Knudson & Associates*** ***8588 Katy Frwy.*** ***Houston, Texas 77024***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the South Post Oak Tax Increment Reinvestment Zone Board in the development of an affordable housing project in Southwest Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council, and the operations provide financial benefits to the City.
Southwest Houston Redevelopment Authority ***c/o Hawes Hill Calderon LLP*** ***P.O. Box 22167*** ***Houston, Texas 77227-2167***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Southwest Houston Tax Increment Reinvestment Zone Board in the redevelopment of the Sharpstown Mall and adjacent neighborhoods southwest of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Upper Kirby Redevelopment Authority ***3015 Richmond Avenue, Suite 200,*** ***Houston, Texas 77098-3114***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Upper Kirby Tax Increment Reinvestment Zone Board in the redevelopment of a neighborhood west of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.
Uptown Development Authority ***1980 Post Oak Blvd., Suite 1580*** ***Houston, Texas 77056***	Local government corporation created by the City in accordance with Chapter 431 of the Texas Transportation Corporation Act to assist the Uptown Tax Increment Reinvestment Zone Board in the redevelopment of the Galleria Mall area, west of Downtown Houston. The City has financial accountability because the voting majority of the board members are nominated by City Council and the operations provide financial benefits to the City.

2. Related Organizations

The following entities are related organizations to which the City appoints board members but for which the City has no significant financial accountability. Some of these organizations are Access Houston Cable Corporation, Coastal Water Authority, Employees Deferred Compensation Plan, Harris County–Houston Sports Authority, Metropolitan Transit Authority of Harris County, Houston Clean City Commission, and the Miller Theater Advisory Council. All transactions with these related organizations are conducted in the ordinary course of business. Further financial information is available from the respective organizations.

C. Basis of Presentation – Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities,* which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities,* which rely to a significant extent on fees and charges for support. Likewise, the *primary government* is reported separately from certain legally separate *component units* for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expense of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

The accounts of the City are organized on the basis of funds, each of which is accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance/retained earnings, revenues, and expenditures/expenses. Government resources are allocated to and accounted for in individual funds for the purpose of carrying on specific activities in accordance with special regulations, restrictions, or limitations. The type and purpose of funds is described below.

Fund Accounting

1. The City reports the following major governmental funds:

(a) ***General Fund*** - is the principal operating fund of the City and is used to account for all financial resources except those required to be accounted for in another fund.

(b) ***Debt Service Fund -*** is used to account for the accumulation of resources for, and the payment of principal, interest, and related costs of tax supported debt.

(c) ***Capital Projects Fund*** - is used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds and trust funds). Such resources are derived principally from proceeds of public improvement bonds and from special assessments.

(d) ***Grants Fund*** - The Grants Fund is used to account for grant resources received from various local, state and national agencies and organizations. The use of these resources is restricted to a particular function of the City by each grantor.

2. The City reports the following major enterprise funds:

(a) ***Airport System Fund -*** is used to account for the operations of the City's Airport System. The system is comprised of George Bush Intercontinental Airport, William P. Hobby Airport, and Ellington Field.

(b) ***Convention and Entertainment Facilities Fund*** - is used to account for the operations of the City's major entertainment facilities, outdoor venues, and parking garages and surface lots. These assets include, but are not limited to, the following: George R. Brown Convention Center, Gus S. Wortham Center, Jesse H. Jones Hall, Houston Center for the Arts, Talento Bilingue de Houston, Jones Plaza, and Theater District parking garages.

(c) ***Combined Utility System Fund*** – is used to account for the production and transmission of water and the treatment of wastewater for City residents and businesses as well as for other governmental entities located in the Houston area.

3. The City reports the following additional funds:

(a) ***Nonmajor Special Revenue Funds*** - are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specific purposes.

(b) ***Nonmajor Enterprise Fund*** – *HAWC* – is used to account for the cost to provide treated, potable water to the City of Houston for sale to customers. *Parking Management* – This is a new fund created to manage parking facilities within the City of Houston.

(c) ***Internal Service Funds*** - are used to account for the financing of goods or services provided by one department to other departments of the City on a cost-reimbursement basis.

(d) ***Fiduciary Fund Types*** - Trust and Agency Funds are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governmental units and other funds. These include the following:

(1) ***Pension Trust Funds*** - are used to account for the assets held in trust for the members and beneficiaries of the City's three defined benefit pension plans.

(2) ***Agency Funds*** - are custodial in nature and do not involve measurement of results of operations.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements display information about the City of Houston as a whole. Government-wide statements exclude both fiduciary funds and fiduciary component units. The statement of net assets and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place, regardless of the timing of related cash flows. Revenues, expenses, gains, losses, assets and liabilities resulting from non-exchange transactions are recognized in accordance with Statement of Government Accounting Standards No. 33, Accounting and Financial Reporting for Nonexchange Transactions. Program revenues include (1) amounts received from those who purchase, use, or directly benefit from a program, (2) amounts received from parties outside the City of Houston's citizenry that are restricted to one or more specific programs and (3) earnings on investments that are legally restricted for a specific program. Program revenue is divided into three categories: (1) charges for services, (2) operating grants and contributions and (3) capital grants and contributions.

All governmental funds are accounted for using the current financial resources measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balances (net current assets) are considered a measure of "available spendable resources." Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of "available spendable resources" during a period.

Non-current portions of certain long-term receivables, primarily property taxes and special assessments, are reported on the balance sheets of governmental funds in spite of their spending measurement focus. Special reporting treatments are used to indicate that they should not be considered "available spendable resources," since they do not represent net current assets. Recognition of governmental fund revenues represented by noncurrent receivables is deferred until they become current receivables.

Because of their spending measurement focus, expenditure recognition for governmental fund types is limited to exclude amounts represented by non-current liabilities. Since they do not affect net current assets, such long-term amounts are not recognized as governmental fund type expenditures or fund liabilities.

Proprietary funds and pension trust funds of the primary government and blended Component Units are accounted for on a cost of services or "economic resources" measurement focus. This means that all assets and all liabilities (whether current or noncurrent) associated with their activity are included on their balance sheets. In accordance with GASB Statement No. 20, the City has elected to follow all Financial Accounting Standards Board (FASB) pronouncements issued prior to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The City has elected not to follow FASB pronouncements issued subsequent to that date. All proprietary funds define operating revenues and expenses consistent with the precepts of Statement of Government Accounting Standards No. 9 paragraphs 16 – 19 and 31: cash receipts from customers, cash receipts from interfund services provided and used with other funds and other operating cash receipts. All other revenue or expenses recognized is non-operating.

Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All governmental funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual; i.e., both measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The City considers receivables collected within sixty days after year-end to be available and recognizes them as revenues of the current period. Expenditures are recognized under the modified accrual basis of accounting in the accounting period in which the fund liability is incurred, if measurable. Claims, judgments and compensated absences are recognized when matured. The following types of revenues are susceptible to accrual under the modified accrual basis of accounting: delinquent property taxes (including penalty and interest); services billed to other funds; sales tax; mixed beverage tax; franchise fees; fines and forfeits; ambulance receipts; and investment earnings. Intergovernmental revenue from reimbursable grants and capital projects is recognized when the related expenditure is incurred.

All proprietary and pension trust funds use the full accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses and related liabilities, including claims, judgments, and compensated absences, are recognized when they are incurred.

When restricted and unrestricted resources are available to cover expenses, unrestricted resources are first applied. Administrative overhead charges are included in direct program expenses.

E. Assets, Liabilities, and Fund Equity

1. Deposits and Investments

The City's investment policy requires all deposits to be fully collateralized with depository insurance; obligations of the United States of America or its agencies and instrumentalities (excluding those mortgage backed securities prohibited by the Public Funds Investment Act); or in any other manner and amount provided by law for the deposits of the City. At all times, such securities should have a fair value of not less than 102% of the amount of the deposits collateralized thereby, adjusted by the amount of applicable depository insurance.

Substantially all cash, except for imprest accounts, is deposited with financial institutions in interest bearing accounts or is invested. The majority of the City's cash and investments are administered using a pooled concept, which combines the monies of various funds for investment purposes. Interest earnings of the pool are apportioned to each fund, unless otherwise required by bond covenants, based on the fund's relative share of the investment pool. All cash and investments are displayed on the statement of net assets as "Equity in pooled cash and investments" and in accordance with GASB Statement No. 31 Accounting and Financial Reporting for Certain Investments and for External Investment Pools, are carried at fair value. The blended and discretely presented component units separately invest their funds and report investments pursuant to their respective investment policies described in their separately audited financial statements at their fair values.

Investments authorized by the City's investment policy, which is guided by state laws and city ordinances, generally include: obligations of the United States of America or its agencies and instrumentalities; fully-collateralized Certificates of Deposit from City Council-approved public depositories; direct obligations of the State of Texas or its agencies and instrumentalities; other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities; obligations of states, agencies, counties, cities, and other political subdivisions; no-load money market mutual funds registered and regulated by the Securities and Exchange Commission; corporate commercial paper; fully collateralized repurchase agreements; and reverse repurchase agreements within specific terms. Investments are carried at fair value based on quoted market prices.

2. Inventories of Materials and Supplies

With the exception of fuel, inventories are carried at the average cost in government-wide, proprietary and governmental funds. Inventories are presented under the consumption method. These inventories include: automobile parts, chemical and medical supplies, uniforms and their accessories, vaccines and office supplies. Fuel is carried based on the first-in, first-out inventory method.

3. Capital Assets

a. Governmental Funds - Property, Plant, Equipment, and Infrastructure

Asset valuation is based on historical costs or estimated historical costs, if original costs are not available.

Capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition and construction are reflected as expenditures in governmental funds.

Capital Assets, which include land; building and improvements; improvements other than buildings, machinery and equipment; construction in progress; and infrastructure (e.g. storm drainage, streets and bridges), are reported in the applicable governmental and business-type activities columns in the government-wide financial statements. These capital assets include the estimated historical cost of infrastructure acquired prior to fiscal year 1981. Capital assets are defined by the government as assets with an initial cost of more than $5,000 (amount not rounded) and an estimated useful life in excess of four years. Such assets are recorded at historical cost or estimated historical if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as a part of the capitalized value of the assets constructed.

Buildings and improvements (improvements other than buildings, machinery and equipment and infrastructure) are depreciated using the straight-line method over the following estimated useful lives:

Assets	Useful Life
Buildings and improvements	Range from 20 to 45 years
Improvements other than buildings	Range from 15 to 30 years
Machinery	Range from 7 to 15 years
Equipment	Range from 3 to 20 years
Storm drainage	50 years
Streets	Range from 6 to 50 years
Bridges	Range from 20 to 50 years

b. Enterprise Funds – Property, Plant and Equipment

Property, plant, and equipment owned by the Enterprise Funds are stated at cost or estimated historical cost if original cost is not available. Construction costs (excluding land and equipment) are added to construction work-in-progress until the assets are substantially complete. At that point, the project is moved to the appropriate asset category and depreciation begins. Depreciation on equipment begins in the year of acquisition. Land and equipment costs are added to the capital asset base in the year of acquisition. Interest costs on funds borrowed to finance the construction of property, plant and equipment of the enterprise funds are capitalized when the costs materially exceed interest earnings on related revenue bond proceeds. For fiscal year 2008, the capitalized interest cost for the Airport System Facilities was $12.1 million, Combined Utility System Fund was $18.6 million and Convention & Entertainment Facilities Fund was $ -0- million.

Depreciation is computed using the straight-line method on the composite asset base over the estimated useful lives as follows:

Assets	Years
Airport System Facilities	4-45
Convention & Entertainment Facilities	4-45
Combined Utility System Facilities	5-50

Water rights and conveyance system rights of the Combined Utility System Fund, and Garage rights of the Convention and Entertainment fund are amortized over the life of the related contracts. These rights are reported as capital assets.

4. Bond Discounts and Issuance Costs

Bond premiums, discounts and issuance costs in Enterprise Funds are amortized over the term of the bonds using the effective interest method. Gains or losses on Enterprise Fund refundings are amortized over the term of the lesser of the new bonds or the refunded bonds using the effective interest method.

5. Fund Balance

a. Reserve - Indicates that portion of a fund balance that has been legally segregated (e.g., by bond ordinance) for specific purposes.

b. Designated Fund Balance - Indicates that portion of a fund balance for which the City has made tentative plans.

c. Undesignated Fund Balance - Indicates that portion of a fund balance that is available for appropriation in future periods.

F. Transfers, Revenues, Expenditures and Expenses

1. Interfund Transactions

A description of the four basic types of interfund transactions and the related accounting policies are as follows:

a. Loans are reported as receivables and payables as appropriate.

b. Charges for services are reported as revenues for the performing fund and expenditures of the requesting fund.

c. Transactions to reimburse a fund for expenditures made by it for the benefit of another fund are recorded as expenditures or expenses in the reimbursing fund and as a reduction of expenditures or expenses in the fund that is reimbursed.

d. All other interfund transfers, such as legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended, are transfers. Transfers are classified as other financing sources or uses (or transfers for proprietary funds) in the Statement of Revenues, Expenditures (or expenses) and Changes in Fund Balances (or net assets). For reporting at the government-wide statements level, the City of Houston eliminates direct interfund charges for services and the balances created within the same fund categories (i.e. governmental vs. business-type). This process ensures neither business-type nor governmental funds report direct internal revenue/expenditures. Interfund activity and balances resulting from transactions with the fiduciary funds are not eliminated. Instead the fiduciary interfund activity and balances are treated as transactions with an external party. Interfund activity with discretely presented component units are handled in the same manner as fiduciary interfund activity balances. However, the discretely presented balances are reported on a separate line of the Statement of Net Assets. The Internal Service Fund is essentially a clearing account for income, expenses, assets and liabilities of the City's health benefits and long-term disability programs.

2. Compensated Absences

Full-time civilian employees of the City are eligible for 10 days of vacation leave per year. After five years, employees receive 15 days. The amount of vacation time gradually increases after that, reaching a maximum of 25 days per year after 18 years of service. Employees may accumulate up to 90 days of vacation leave (45 days for employees hired after December 31, 1999). Upon termination or retirement, employees are paid for unused vacation leave based on the average rate of pay during the employee's highest paid 60 days of employment. Part-time employees (those working less than 30 hours per week) are not eligible for vacation leave benefits. Firefighters accrue 15 to 22 days of vacation annually, based upon years of service. Police officers participate in a paid time off program that combines sick and vacation leave. Officers enter the program upon completion of their probationary period and then accrue 15 to 40 days annually, based upon years of service.

The majority of full-time civilian employees and firefighters are covered under the compensatory sick leave plan and receive a leave time allowance of 2.5 hours per payroll period (bi-weekly) up to a maximum of 65 hours per year. Employees who use fewer than 65 hours during the benefit year will receive a match of additional hours equal to the number of hours accrued minus the number of hours used. Once an employee's balance has reached 1,040 hours, no additional match for unused hours is given. Upon termination, all unused sick leave time allowances in excess of 1,040 hours are payable to the employee at the employee's rate of pay at the time of termination. An employee who uses less than 16 hours of sick leave in any benefit year receives up to three days of personal leave in the next year. Personal leave may be used in place of vacation leave, but will not accumulate and will not be paid out at termination. The balance of full time civilian employees and firefighters are covered by a sick plan that was closed to employees in 1985. That plan accumulates a cash value for every sick day not used, which is payable upon resignation or retirement. As noted above, classified police officers are covered by a paid time off plan.

The City also has adopted policies of compensatory time to comply with the Fair Labor Standards Act as amended in 1985. These policies provide limits to the accumulation of compensatory time and also provide that time not used will be paid in cash. Only classified employees and civilian employees in certain pay grades routinely earn compensatory time.

To the extent that the City's obligation is attributable to employees' services already rendered and it is probable that the City will compensate the employees for the benefits through paid time off or some other means, vacation and compensatory time benefits are accrued as liabilities (on a government-wide basis) as employees earn the benefits. On a fund financial statement basis for the governmental funds, only matured liabilities and liabilities expected to be liquidated with current assets are accrued. Sick leave benefits are accrued as a liability as employees earn the benefits, but only to the extent that it is probable that the City will compensate the employees through cash payments conditioned on the employees' termination or retirement. A compensated absence is liquidated in the fund where the employee's salary was paid at termination, with all compensated absences liquidated in the general fund that are associated with employees' salaries paid from governmental funds.

G. Estimates

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

H. Internal Service Funds

The Internal Service Funds' purpose is to measure the full cost of providing health benefits and long- term disability to City employees and dependants for the purpose of fully recovering that cost through fees or charges – employee payroll deductions and expenditures in departmental personnel budgets. Any profit (loss) during a period is credited (charged) back to participating programs. All assets and liabilities are reported in the governmental activities column of the Statement of Net Assets.

I. New Accounting Pronouncements

In November 2006, the GASB issued Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations". Statement No. 49 addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The requirements for this statement are effective for financial statements for periods beginning after December 15, 2007. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

In June 2007, the GASB issued statement No. 51, "Accounting and Financial Reporting for Intangible Assets". This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The requirements of this statement are effective for periods beginning after June 15, 2009. The City has not determined the impact, if any, upon its financial position, results of operations, or cash flows upon adoption.

In November 2007, the GASB issued statement No. 52, "Land and Other Real Estate Held as Investments by Endowments". This statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2008. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

In June 2008, the GASB issued statement No. 53, "Accounting and Financial Reporting for Derivative Instruments". This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

Note 2: Reconciliation of Government-wide and Fund Financial Statements

A. Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Statement of Net Assets

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities in the governmental fund statements. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due. All liabilities - both current and long-term - are reported in the government-wide statement of net assets. Also, during the year the City refunded some of its existing debt. The amount borrowed is received in the governmental funds and increases fund balance. The amount that was sent to the paying agent to be escrowed for payment of the old debt as it comes due is paid out of governmental funds and reduces fund balance. The difference between those amounts will be amortized as an adjustment to interest expense in the government-wide statement of activities over the remaining life of the refunded bonds.

Balances at June 30, 2008, were (in thousands):

Unamortized bond issuance cost	$	17,128
Section 108		15,060
Deferred revenue		79,546
	$	111,734

Internal Service Fund total assets	$	17,790
Internal Service Fund liabilities		(11,050)
Cumulative asset resulting from undercharging the enterprise funds		591
	$	7,331

Bonds, notes, and capital lease payable	$	(3,074,229)
Arbitrage rebate payable		(242)
Accrued interest		(49,571)
Compensated absences not reported at the fund level		(397,065)
Claims and judgments not reported at the fund level		(130,657)
Net pension obligation (liabilities less assets)		(561,765)
Other post employment benefits		(239,622)
	$	(4,453,151)

B. Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities

Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the government-wide statement of net assets, however, issuing debt increases long-term liabilities and does not affect the government-wide statement of activities. Similarly, repayment of principal is an expenditure in the governmental funds, but reduces the liability in the government-wide statement of net assets.

Balances at June 30, 2008 were (in thousands):

Debt issued:		
Public Improvement Bonds	$	219,660
Certificates of Obligations		8,575
Pension Obligations		51,549
Commercial paper		343,000
Premium/Discount on bonds		9,004
Capital appreciation bonds accretion		373
	$	632,161
Repayments:		
Refunded commercial paper	$	(177,800)
Refunded bonds		(51,030)
Deferred Electricity Note		(1,426)
Principal payments		(198,357)
	$	(428,613)
Amortization of:		
Deferred gain	$	2,248
Premium		(6,390)
Net adjustment	$	199,406

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable available financial resources. In the government-wide statement of activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due, rather than as it accrues. The adjustment is a combination of the following items (in thousands):

Property taxes earned but not available	$	30,362
Ambulance fees earned but not available		2,676
Fines and forfeits earned but not available		6,329
Other (primarily assessments) earned but not available		40,179
Total revenue not reported at fund level	$	79,546
Property taxes for prior periods	$	(31,415)
Ambulance fees for prior periods		(1,144)
Fines and forfeits for prior periods		(2,555)
Other (primarily assessments) for prior periods		(62,648)
Total revenue for prior period transactions	$	(97,762)
Interest on long-term debt	$	3,908
Municipal Employees pension		(15,102)
Police Officers' pension		(66,522)
Firefighters' pension		(12,717)
Claims and judgments		(8,799)
Debt issuance costs		1,926
Amortization of debt issuance costs		(1,184)
Compensated absences		(23,374)
Other liabilities		373
Other post employment benefits		(239,622)
Decrease in other receivables		1,407
Total differences in accrued expenses	$	(359,706)

Note 3: **Deposits and Investments**

A. Deposits

At June 30, 2008 the carrying amount of the City's deposits was ($17,103,929). The City's bank balance is the sum of three accounts which total $54,556,514. The three accounts that comprise this balance are described by the following:

Accounts	Ledger	Collected
Concentration	$ 38,860,197	$ 15,000,000
Section 108	374,229	374,229
JPM Money Market Account	15,322,088	15,322,088
Total	$ 54,556,514	$ 30,696,317
Mkt Value Collateral	$ 26,133,078	$ 26,133,078

The first account is a demand deposit account with JP Morgan Chase bank that as of June 30, 2008 had a City balance of $38,860,197 and a bank balance of $15,000,000. The difference between the ledger and collected balance of $23,860,197 represents checks deposited in this bank account but uncollected by the bank. A Depository Pledge Agreement is in effect by which collateral is pledged by JP Morgan Chase to the City to cover collected balances. The collateral is in the form of high quality fixed income securities, held by a third party. As of June 30, 2008 the collateral had a market value of $26,133,078. According to the terms of the pledge agreement the City is granted a security interest in the pledged securities. In the event of a default by JP Morgan Chase, the City may sell the pledged securities to satisfy any indebtedness owed to the City by JP Morgan Chase, provided at least 3 business days written notice and opportunity to cure the default is given.

The second account is a demand deposit account with JP Morgan Chase Bank for the City's Housing and Urban Development section 108 account, which had a collected and ledger balance as of June 30, 2008 of $374,299. This balance was collateralized by the same Depository Pledge Agreement described above.

The third account is a highly rated, SEC registered money market fund. The balance in the money market fund as of June 30, 2008 was $15,322,088. As this is not a bank account, collateral is not required to be held to cover the balance. There is no custodial risk associated with this money market fund.

B. Investments and Risk Disclosures

The following describes the investment positions of the City's operating funds as of June 30, 2008. As of that date, the City had approximately $2.3 billion in fixed income investments in four separate investment pools, each serving a specific purpose as described below. All investments are governed by state law and the City's Investment Policy, which dictates the following objectives, in order of priority:

1. Safety
2. Liquidity
3. Return on Investment
4. Legal Requirements

These funds are managed internally by City personnel. The investments listed below do not include the City's three pension funds, which are described elsewhere in this report.

1. General Investment Pool 9900 (Pool 960)
The General Investment Pool consists of all working capital, construction and debt service funds which are not subject to yield restriction under IRS arbitrage regulations. The funds of the City's enterprise systems, as well as the general fund, are commingled in this pool in order to gain operational efficiency. Approximately 98.7% of the City's total investable funds are contained in this portfolio.

City of Houston Investments As of June 30, 2008	Credit Quality Ratings(1)(2)	Market Value	WAM* (yrs)
U.S. Treasury Notes	n/a	$ 360,744,951	0.364
Housing and Urban Development Notes	not rated	46,287,909	2.244
Government National Mortgage Association Notes	not rated	1,878,784	0.469
Agency Notes (4)	AAA	940,259,154	2.265
Agency Notes (3) (4)	not rated	212,639,110	0.134
Collateralized Mortgage Obligations (3) (4)	not rated	12,600,893	1.916
Mortgaged Backed Securities (3) (4)	not rated	248,767,919	4.384
Money Market Mutual Fund	AAA	250,489,772	0.085
Municipal Bonds	AAA	81,622,817	1.855
Municipal Bonds	SP-1+/MIG1	20,961,441	0.530
Municipal Bonds	AA	52,792,621	2.155
Municipal Bonds	A	16,139,591	0.055
Total Investments		**$ 2,245,184,962**	**1.732**

* Weighted Average Maturity (WAM) computed using average life of mortgage backed securities and effective maturity of callable securities.

(1) Standard and Poor's Rating Services has assigned an AAAf credit quality rating and S1 volatility rating to the City's General Investment Pool. The AAAf signifies the highest level of credit protection, and the S1 rating signifies volatility consistent with a portfolio of government securities maturing from one to three years.

(2) All credit ratings shown are either actual Standard and Poor's (S&P) ratings, or if an S&P credit rating is not available, the equivalent S&P credit rating is shown to represent the actual Moody's or Fitch credit rating.

(3) These securities are not individually rated by the rating agencies. The issuers of these securities, which includes the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Corporation ("Fannie Mae"), are rated AAA by the rating agencies. Federal Agricultural Mortgage Corporation ("Farmer Mac"), which comprises 1.3% of this portfolio, is not rated by the credit rating agencies as to the individual securities or as an issuer. Farmer Mac is a government sponsored enterprise and is a permitted investment under state law and City investment policy.

(4) These are securities issued by government sponsored enterprises, including the Federal Home Loan Bank, Freddie Mac, Fannie Mae, Farmer Mac, and Farm Credit.

Risk Disclosures:
Interest Rate Risk. In order to ensure the ability of the City to meet obligations and to minimize potential fair value losses arising from rising interest rate environments, the City's investment policy limits this investment portfolio's dollar-weighted average stated maturity to 2.5 years maximum. As of June 30, 2008, this investment portfolio dollar-weighted average stated maturity is 1.732 years. Modified duration for the same period is 1.35. Modified duration can be used as a multiplier to determine the percent change in price of a bond portfolio for every 100 basis point (1%) change in yield. For example, a portfolio with a modified duration of 1.35 would experience approximately a 1.35% change in market price for every 100 basis point change in yield.

Credit Risk: The US Treasury Notes Housing and Urban Development Notes, and the Government National Mortgage Association instruments are direct obligations of the Unites States government.

The Agency Notes, Collateralized Mortgage Obligations and Mortgage Backed Securities were issued by government sponsored enterprises but are not direct obligations of the U.S. Government. The money market mutual fund holds were rated AAA. Municipal securities considered short-term securities at time of issue had the highest short-term credit rating of SP-1 or MIG-1.

Custodial Credit Risk. The custodial credit risk for investments is the risk that in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008, none of the City's investments in the General Investment Fund 9900 (Pool 960) were subject to custodial credit risk.

Reverse Repurchase Agreements:
From time to time the City participates in reverse repurchase agreements whereby it enters into agreements to sell certain securities with an agreement to repurchase them with interest at a future date. The process of the sale are then invested at a positive spread in high grade commercial paper or money market funds. The purpose of the agreements is to earn incremental income. The City had no reverse repurchase agreements outstanding at June 30-, 2008.

2. Tax Exempt Fund 9901 (Pool 971)
The Tax Exempt Pool consists of those funds which are subject to yield restrictions and arbitrage regulation under the1986 Tax Reform Act. All these investments were held in a tax-exempt money market fund.

City of Houston Investments As of June 30, 2008	Credit Quality Ratings	Market Value	WAM
Fidelity Tax-Exempt Money Market Mutual Fund	SEC 2a-7 fund	$17,112,015	<90 Days

Risk Disclosures:
Interest Rate Risk. In order to ensure the ability of the City to meet obligations and to minimize potential fair value losses arising from rising interest rate environments, the City's investment policy limits this pool's dollar-weighted average maturity to 1 year. As of June 30, 2008, all funds were invested in a SEC registered money market fund that kept a weighted average maturity of less than 990 days. Funds were available on same day notice.

Credit Risk. Due to the nature of municipal bonds (more risk, and less liquidity), the City investment policy limit its investments in the Tax-Exempt Pool to high quality, short maturity securities with an average dollar-weighted maturity of less than one year and a minimum rating of A, if the yield is reasonably higher than that of a tax-exempt money market mutual funds. Otherwise, funds in this pool will be invested in one or more tax-exempt money market mutual funds that are SEC registered and regulated under rule 2a-7. Rule 2a-7 requires that the fund have a weighted average maturity of less than 90 days to maturity, that individual securities cannot be more than 397 days to maturity, and that securities must have a rating by nationally recognized rating agencies in one of the two highest short-term rating categories.

Custodial Credit Risk. The custodial credit risk for investments is the risk that in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008 none of the City's investments in the Tax Exempt Fund (Pool 971) were subject to custodial credit risk.

3. Housing Department Section 108 Pool Fund 9902
The Housing Department Pool was created to comply with rules of the US Department of Housing and Urban Development ("HUD"), which requires that funds provided by HUD must be held in a separate custodial account for HUD's benefit. The primary goal of this fund is to meet the cash and investment needs of the City's Housing and Community Development HUD program cash flows.

City of Houston Investments As of June 30, 2008	Credit Quality Ratings	Market Value	WAM
U.S. Treasury Bills	NA	$4,589,073	10-Days

Risk Disclosures:
Interest Rate Risk. In order to ensure the ability of the City to meet obligations and to minimize potential fair value losses arising from rising interest rate environments, the City's investment policy limits this investment portfolio's dollar-weighted average stated maturity to 6.0 months maximum. As of June 30, 2008, this investment portfolio's dollar-weighted average stated maturity is 10 days. Modified duration for the same period is 0.045 year.

Credit Risk. The HUD pool consists only of U.S. Treasury Bills with maturities less than 6 months. HUD requires that investment of these funds must be in direct obligations of the United States Government.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008 none of the City's HUD Pool's investments were subject to custodial credit risk.

4. Convention Center and Hotel Reserve Fund 9903 (Pool 979)

The Convention Center and Hotel Reserve Fund Pool consists of proceeds from the 2001 Series A, B and C Hotel Occupancy Tax and Special Revenue Bond issues designated as reserve funds.

City of Houston Investments As of June 30, 2008	Credit Quality Ratings	Market Value	WAM (yrs)
MBIA Flex Repo	not rated	$22,197,460	3.173

Risk Disclosures:

Interest Rate Risk. This is a fixed rate investment provided by MBIA Inc. By contract, the market value of this investment is held at a constant value because it is collateralized for 105% of its par value (see credit risk below).

Credit Risk. This investment is collateralized with fixed income government securities that are held by a third party. The market value of that collateral is maintained at least 105% of the par value of this investment, and is monitored monthly.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008, the City's investments that were subject to custodial credit risk were the collateral securities for the MBIA Flex Repo, held by an independent third party custodian (Wells Fargo) with whom the City has a current custodian agreement.

5. Miscellaneous Money Market Accounts

The City maintains several separate money market account balances for various purposes described below:

City of Houston Investments As of June 30, 2008	Credit Quality Ratings	Market Value	WAM (yrs)
JP Morgan US Government Money Market Fund: Airport System Special Facilities Revenue Bonds Series 1997A Reserve Fund.	AAA	$ 6,871,409	< 90 days
JP Morgan US Treasury Securities Money Market Fund: Balances held for auction bonds debt service.	AAA	1,007,991	< 90 days
First American US Treasury Money Market Fund: Balances held for commercial paper debt service.	AAA	426,834	< 90 days
Total Miscellaneous Money Market Funds		$ 8,306,234	

Risk Disclosures:

Interest Rate Risk. These money market funds maintain an average maturity of less than 90 days and seek to maintain a stable net asset value of $1.00. These funds are redeemable on a same day notice.

Credit Risk. These funds hold only US dollar denominated securities that present minimal credit risk. They have the highest credit ratings.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008 none of the City's investments in the previous noted money market funds were subject to custodial credit risk.

6. Houston Foundation

The Houston Foundation consists of two trusts. The Hill Trust is reported as an Other Non-Major Special Revenue fund; its investments are laid out below. The Hill Trust was established by will in the early 1900's as a general purpose charity trust. The trust is administered by an outside trustee. The City's Administration and Regulatory Affairs Department provides administrative support to the foundation and its board.

City of Houston Investments As of June 30, 2008	Credit Quality Ratings	Market Value	WAM (yrs)
Cash and Equivalents	not rated	$ 61,152	n/a
Fixed Income	not rated	1,759,687	4.13
Equities	n/a	979,350	n/a
Other	n/a	12	n/a
Total Assets		**$ 2,800,201**	

Risk Disclosures:
Interest Rate Risk. The cash and fixed income portions of this portfolio are invested in mutual funds, US Agency Securities, and Corporate Bonds. Roughly 4% of the portfolio is allocated to Columbia Short-Term Bond Fund with average maturity of 2.0 years, 9% is allocated to Columbia Strategic Income Fund with an average maturity of 8.7 years, 68% is allocated to Corporate Bonds with maturities less than 5 years, and 33% is allocated to U.S. Agency Bonds with maturities less than 5 years. The weighted average maturity for the fixed income portfolio is approximately 4.13 years, and the weighted average duration is 3.13 years.

Credit Risk. The allocation of assets among various asset classes are set by the board. The Moody's quality rating for the fixed income portfolio are as followed: 46% is rated AAA, 29% is rated AA, 14% is rated A, and 11%, mainly mutual funds, are not rated. The equities portion of this portfolio is invested in common stocks and Columbia's mutual funds.

Custodial Credit Risk. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2008 all of the foundation's holdings in the above noted mutual funds, corporate bonds, and common stocks were subject to custodial credit risk.

7. Investments – Houston Area Water Corporation

As of June 30, 2008, the Corporation had the following investments:

Investment	Weighted Average Maturity	Fair value
Wells Fargo Treasury Plus Money Market Fund	4 days	$ 918,559
JP Morgan U.S. Government Money Market Fund	52 days	1,970,858
		$ 2,889,417

Custodial Credit Risk. Custodial credit risk is the risk that in the event of a bank failure, the Corporation's deposits may not be returned to it. The corporation does not have a deposit policy for custodial credit risk. The Corporation did not have any custodial credit risk as of June 30, 2008.

Interest Rate risk: The Corporation does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: State law limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations. The corporation has no investment policy that would further limit its investment choices. Wells Fargo Treasury Plus Money market Fund and JP Morgan U.S. Government Money Market Fund were rated AAAm by S&P Rating and Aaa by Moody's Rating.

8. Investments – Municipal Employees Pension System (the "System")

Portions of the System's investments are classified as security investments. A security is a transferable financial instrument that evidences ownership or creditorship. Investments in commingled funds, limited partnerships, real estate trusts, and loans and mortgages are investments that are evidenced by contracts rather than securities.

The fair values of the System's investments at June 30, 2008, are presented by type, as follows:

Short-term investment funds	$	50,709,924
Government securities		46,189,118
Corporate bonds		88,482,458
Capital stocks		487,616,910
Commingled funds		537,365,408
Real assets		338,905,427
Alternative investments		336,774,854
	$	1,886,044,099

The System's Board (Board), in accordance with the power and authority conferred under the Texas Statutes, employed State Street Bank and Trust Company (Custodian) as custodian of the assets of the System, and in said capacity, the Custodian is a fiduciary of the System's assets with respect to its discretionary duties including safekeeping the System's assets.

The Custodian shall establish and maintain a custodial account to hold, or direct its agents to hold, for the account of the System all assets that the Board shall from time to time deposit with the Custodian. All rights, title and interest in and to the System's assets shall at all times be vested in the System's Board.

In holding all System assets, the Custodian shall act with the same care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in like capacity and familiar with matters of this type would use in the conduct of an enterprise with a like character and with like aims. Further, the Custodian shall hold, manage and administer the System's assets for the exclusive purpose of providing the benefits to the members and the qualified survivors of the System.

The Board shall manage the investment program of the System in compliance with all applicable Federal and State statutes and regulations concerning the investment of pension assets. The Board has adopted a Statement of Investment Policies and Objectives (Investment Policy) to set forth the factors involved in the management of investment assets for the System and is made part of every investment management agreement.

Custodial credit risk. For an investment, custodial credit is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the System, and are held by either the counterparty or the counterparty's trust department or agent but not in the System's name. At June 30, 2008, the System's investments that were not subject to custodial credit risk were the investments in U.S. government securities and corporate bonds as they are registered in the name of the System and held in possession of the Custodian.

Concentration of credit risk. The allocation of assets among various asset classes are set by the Board. For major asset classes (e.g., U.S. equity, international equity, fixed income, real assets, and alternative investments), the System will further diversify by employing managers with demonstrated skills in complementary areas of expertise.

The managers retained will utilize varied investment approaches, but, when combined will exhibit characteristics that are similar, but not identical, to the asset class proxy utilized in the strategic asset allocation plan. The Investment Policy of the System provides that no investment manager shall have more than 15% (at market value) of the System's assets in one investment style offered by the firm, with the exception of passive management.

Representative guidelines by type of investment are as follows:

U.S. equity managers

1. A manager's portfolio shall contain a minimum of twenty-five issues.
2. No more than 5% of the manager's portfolio at market shall be invested in American Depository Receipts.
3. No individual holding in a manager's portfolio may constitute more than 5% of the outstanding shares of an issuer.
4. No individual holding may constitute more than 5% of a manager's portfolio at cost or 10% at market.
5. Short sales, purchases on margin, non-negotiable or otherwise restricted securities are prohibited, other than where expressly permitted.
6. While there are no restrictions on cash, a manager must notify the System if the cash position exceeds 10%.

International equity managers

1. Not more than 5% at cost and 10% at market value of a manager's portfolio shall be invested in the securities of any one issuer.
2. Not more than 30% of the assets of a manager's portfolio (at market value) shall be invested in any one country with the exception of Japan.
3. While there are no restrictions on cash, a manager must notify the System if the cash position exceeds 10%.
4. Currency forwards and futures will be limited as follows:
    a. Limits on net forward and future sales of currencies will be addressed in each manager's respective Guidelines and Objectives,
    b. Forward and future exchange contracts of any currencies, other than Yen, Sterling and Euro shall be limited to the manager's underlying equity position in the local market,
    c. Foreign exchange contracts with a maturity exceeding 12 months are prohibited, and
    d. Currency options may be entered into in lieu of or in conjunction with forward sales of currencies. The same effective limitations specified in (a) through (c) above will apply to currency options.

Fixed income managers

1. No more than 10% of a manager's portfolio at market shall be invested in the securities of any single issuer, with the exception of the U.S. government and its agencies.
2. No individual holding in a manager's portfolio shall constitute more than 10% of the market value of an issue.

Global opportunistic fixed income/high yield managers

1. No more than 5% at cost and 10% at market value of a manager's portfolio shall be invested in the securities of any single issuer, with the exception of the U.S. government and its agencies.

There is no security issued by a single issuer that is being held with market value over 5% of the System's plan net assets as of June 30, 2008.

Interest rate risk. The System invests in fixed income securities including, but not limited to, investments representing instruments with an obligated fixed rate of interest including public and private debentures, mortgages, investments in life insurance general accounts and guaranteed investment contracts, with maturities greater than one year, and options/futures. Instruments may have an investment grade or non-investment grade rating. Purchases and sales, investment selection and implementation of investment strategies are delegated to the discretion of the investment manager, subject to compliance with its management agreement and the Investment Policy.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. This risk is managed within the portfolios using the effective duration or option-adjusted methodology. The System's investment policies require that the portfolio shall maintain a duration within +/- 20% of the Lehman Aggregate Bond index; and maintain a credit quality weighted average of AA-, or equivalent. Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price.

The greater the duration of a bond, or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Duration is the measure of a bond price's sensitivity to a 100-basis point change in interest rates. The duration of the System's debt securities are managed by the active managers.

At June 30, 2008, the following table shows the System's investments by type, amount and the effective duration rate calculated using the software Wilshire Axiom.

	Effective Duration	Domestic	International	Fair Value
Collateralized mortgage obligations	6.12	$ 8,567,670		8,567,670
Convertible bonds	9.82	8,317,513		8,317,513
Corporate bonds	9.84	58,351,072		58,351,072
Corporate bonds	6.35		7,929,239	7,929,239
GNMA/FNMA/FHLMC (Sponsored Agencies)	5.01	30,674,118		30,674,118
Government issues (United States)	6.96	10,090,918		10,090,918
Government issues (International)	10.93		4,158,775	4,158,775
Zero coupon bond	n/a	1,265,307		1,265,307
Misc. receivable (Auto/Credit card)	0.32	767,569		767,569
Other asset backed	3.46	4,286,261	263,134	4,549,395
	6.22	$ 122,320,428	12,351,148	134,671,576

Credit risk. The quality ratings of investments in fixed income securities are set forth in the Investment Policy as follows:

1. All issues purchased must be of investment grade quality Baa (Moody's) or BBB (S&P) unless expressly authorized by the Board, in which case a minimum B rating shall apply, with a maximum limit of non-investment grade credits of 20% at market.

2. For global opportunistic fixed income/high yield securities, more than 50% of a manager's portfolio at market shall be invested in non-investment grade fixed income securities, i.e. those with ratings of BA1 (Moody's), BB+ (Standard & Poor's), or lower, or unrated bonds, including but not limited to corporate bonds, convertible bonds, and preferred stocks.

The quality ratings of investments in fixed income securities as described by nationally recognized statistical rating organizations at June 30, 2008 are as follows:

Quality Rating	CMO	Convertible Bonds	Corporate Bonds	Sponsored Agencies	Government Issues (International)	Other	Other Asset Backed	Grand Total Fair Value	Percentage of Holdings
AAA	$ 7,360,076			4,505,827	516,042		818,476	$ 13,200,421	9.80%
AA		320,800	959,781			494,650	393,185	2,168.416	1.61%
AA+	5,075		442,696					447,771	0.33%
AA-			1,794,443					1,794,443	1.33%
A			1,378,737				81,249	1,459,986	1.08%
A-			2,052,072				242,002	2,294,074	1.70%
A+			1,706,097		1,825,804			3,531,901	2.62%
BBB			4,803,802					4,803,802	3.57%
BBB-			4,224,944		1,740,072		450,770	6,415,786	4.76%
BBB+			3,248,326				439,741	3,688,067	2.74%
BB		558,038	4,727,482				650,377	5,935,897	4.41%
BB+			4,672,740		76,858		75,845	4,825,443	3.58%
BB-			4,382,334				302,753	4,685,087	3.48%
B		320,854	9,351,092					9,671,946	7.18%
B+		335,125	6,398,924					6,734,049	5.00%
B-		1,356,563	5,645,942					7,002,505	5.20%
Below C	143,223	1,112,156	7,369,680					8,625,059	6.40%
NA	1,059,297	4,313,978	3,121,219	26,168,291		272,919	1,094,998	36,030,702	26.78%
Subtotal	$ 8,567,671	8,317,514	66,280,311	30,674,118	4,158,776	767,569	4,549,396	123,315,355	91.57%
	Total credit risk debt securities							**123,315,355**	**91.57%**
	U.S. government fixed income securities*							**11,356,225**	**8.43%**
	Total fixed income securities							**$ 134,671,580**	**100.00%**

*Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not have purchase limitations.

Foreign currency risk. International securities investment managers are expected to maintain diversified portfolios by sector and by issuer using the System's Investment Policy.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. Each investment manager, through the purchase of units in a commingled investment trust fund or international equity mutual fund, establishes investments in international equities. The System has an indirect exposure to foreign currency fluctuation as of June 30, 2008 as follows:

		Fair Value	Percentage of Holdings
Australian Dollar	$	4,731,169	2.4 %
Brazillian Real		1,997,378	1.0 %
Canadian Dollar		22,297,022	11.1 %
Danish Krone		3,392,452	1.7 %
Euro Currency		51,358,787	25.5 %
Hong Kong Dollar		3,449,216	1.7 %
Indonesian Rupiah		3,267,993	1.6 %
Japanese Yen		46,164,938	22.9 %
Malaysian Ringgit		1,113,638	0.6 %
Mexican Peso		1,835,140	0.9 %
New Taiwan Dollar		1,320,537	0.7 %
New Zealand Dollar		1,363,403	0.7 %
Norwegian Krone		6,248,947	3.1 %
Pound Sterling		39,562,664	19.7 %
Singapore Dollar		516,038	0.2 %
South Korean Won		2,146,140	1.1 %
Swedish Krona		2,249,315	1.1 %
Swiss Franc		8,131,638	4.0 %
Total securities subject to foreign currency risk	$	201,146,415	100.0 %

9. Investments – Houston Firefighters' Relief and Retirement (HFRRF) Fund

Statutes of the State of Texas authorize the HFRRF to invest surplus funds in the manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. This subchapter provides for the investment of surplus assets in any investment or investments that are deemed "prudent" by the HFRRF Board. The investment policy of the HFRRF Board does not restrict the types of investments authorized to be made on behalf of the HFRRF; however, the Board seeks to produce a return on investments that is based on prudent and reasonable investment risk and the cash flow requirements of the HFRRF given prevailing capital market conditions. While the HFRRF Board recognizes the importance of the preservation of capital, it also adheres to the theory of capital market pricing which maintains that varying degrees of investment risk should be rewarded with incremental returns. Consequently, prudent risk-taking is justifiable.

The HFRRF Board has employed Mellon Trust (HFRRF Custodian) as HFRRF Custodian of the assets of the HFRRF, and in said capacity, the HFRRF Custodian shall be a fiduciary of the HFRRF's assets with respect to its discretionary duties including safekeeping the HFRRF's assets. The HFRRF Custodian shall establish and maintain a custodial account to hold, or direct its agents to hold, for the account of the HFRRF all assets that the HFRRF Board shall from time to time deposit with the HFRRF Custodian. All right, title and interest in and to the HFRRF's assets shall at all times be vested with the HFRRF's Board.

In holding all HFRRF assets, the HFRRF Custodian shall act with the same care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in like capacity and familiar with matters of this type would use in the conduct of an enterprise with a like character and with like aims. Further, the HFRRF Custodian shall hold, manage and administer the HFRRF 's assets for the exclusive purpose of providing the benefits to the members and the qualified survivors of the HFRRF Fund.

The HFRRF Board shall manage the investment program of the HFRRF in compliance with all applicable Federal and State statutes and regulations concerning the investment of pension assets. The HFRRF Board has adopted an Investment Policies and Procedures (Investment Policy) to set forth the factors involved in the management of investment assets for the HFRRF. The HFRRF Board has established an Investment Committee to act on all matters related to investments.

The fair values of the HFRRF's investments as of June 30, 2008 by type are as follows:

Short-term investment funds	$	89,883,727
Fixed Income		954,752,944
Common equity		1,309,360,620
Preferred equity		12,801,872
Alternative investments		142,358,591
Private equity		334,354,229
Real Estate		165,779,034
Total investments	$	3,009,291,017

Portions of the HFRRF's investments are classified as security investments. A security is a transferable financial instrument that evidences ownership or creditorship. Investments in partnerships and real estate are investments that are evidenced by contracts rather than securities.

Custodial credit risk. For an investment, custodial credit is the risk that, in the event of the failure of the counterparty, the HFRRF will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the HFRRF, and are held by either the counterparty or the counterparty's trust department or agent but not in the HFRRF's name. At June 30, 2008, the HFRRF's security investments that were not subject to custodial credit risk were the investments not registered on an exchange.

Concentration of credit risk. The allocation of assets among various asset classes is set by the HFRRF Board with the objective of optimizing the investment return of the HFRRF within framework of acceptable risk and diversification. For major asset classes (e.g., domestic equities, international equities, fixed income, alternative investments, private equity and real estate), the HFRRF will further diversify by employing investment managers who implement the strategies selected by the Investment Committee.

Significant risk management asset allocation guidelines are as follows:

Public market investments

1. Specific guidelines will be developed cooperatively by the HFRRF's investment staff, legal counsel, and investment manager and shall be incorporated into the Investment Management Services Contract executed by the Chair of the Investment Committee, Executive Director and the investment manager.

2. In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. The general guidelines are as follows:

    a. Manager investment philosophy, style, and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.
    b. The following transactions are prohibited: short sales, selling on margin, put and call options, and the use of derivatives for speculation unless authorized by the Investment Committee.

    c. Transactions that involve a broker acting as a principal, where such broker is also affiliated with the manager who is making the transaction are prohibited, unless specifically approved by the Investment Committee.

    d. Transactions shall be executed at competitive costs, or within the parameters established for directed brokerage transactions by the Investment Committee.

    e. Managers shall maintain cash levels consistent with their style as presented to the Investment Committee at the time of selection. Any deviation shall be allowed only after notifying the Chief Investment Officer and Executive Director and should be related to unusual market conditions. The maximum cash level to be held by each manager will be addressed in the Investment Management or other binding agreement as is appropriate for the investment.

3. The Investment Committee with the assistance from the HFRRF staff shall monitor each investment manager's performance and adherence to style, strategy, and manager specific guidelines. It is the Investment Committee's discretion to take corrective action by replacing an investment manager if they deem it appropriate at any time.

Alternative and real estate investments

1. The investment specific guidelines for each manager will be incorporated in a Limited Partnership Agreement, Limited Liability Company Agreement, or other binding agreement as is appropriate for the investment. The Chair of the Investment Committee and the manager execute this document.

2. In case of conflict between the specific manager guidelines and the general guidelines, the specific guidelines, as approved by the Investment Committee, shall supersede. Manager investment philosophy, style, and strategy shall remain consistent and shall not change without the Investment Committee's approval. The manager shall have discretion to manage the portfolio consistent with the style presented to the Investment Committee at the time of selection and further subject to the restrictions established by the policy herein.

3. The Investment Committee with assistance from the HFRRF staff shall monitor each Alternative and Real Estate manager's performance and adherence to strategy and manager specific guidelines. It is the Investment Committee's discretion to take corrective action by replacing an investment manager if they deem it feasible and appropriate at any time. Alternative and Real Estate investment manager retention is governed in most cases by Limited Partnership Agreements, Limited Liability Company Agreements, or other binding agreements. In these cases, the Investment Committee with assistance from the HFRRF staff shall identify available options as allowed by the governing documents and determine the impact and consequences of these options.

As of June 30, 2008, the HFRRF Fund's investments had no single holdings in excess of 5% of HFRRF net assets. As of June 30, 2007, the Fund's investment of $193,175,604 in an individual U.S. Treasury Bond exceeded 5% of HFRRF net assets.

Interest rate risk. The Fund invests in fixed income securities including, but not limited to, investments representing instruments with an obligated fixed rate of interest including public and private debentures, mortgages, investments in life insurance general accounts and guaranteed investment contracts, with maturities greater than one year, and options/futures. Instruments may have an investment grade or non-investment grade rating. Purchases and sales, investment selection and implementation of investment strategies are delegated to the discretion of the investment manager, subject to compliance with its management agreement and the HFRRF's Investment Policy.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. Interest rate risk is the greatest risk faced by an investor in the fixed income market. The price of a fixed income security typically moves in the opposite direction of the change in interest rates. The weighted average maturity expresses investment time horizons (when the investment come due and payable) in years, weighted to reflect the dollar size of individual investments within the investment type. The HFRRF does not have a formal investment policy that limits investment maturities as a means of managing its exposure to potential fair value losses arising from future changes in interest rates, but rather mandates such limits within the Investment Management Services Contract.

At June 30, 2008, the following table shows the HFRRF's investments by type, with weighted average maturity and fair value:

	Weighted Average Maturity	Fair Value
Asset Backed Securities	8.02	$ 102,612,612
Consumer Discretionary	5.17	1,877,625
Corporate Debt	17.25	584,017,009
Energy	0.09	1,965,850
Financials	21.59	1,739,140
U.S. Government Issues	5.24	26,688,251
Healthcare	4.69	11,379,275
Industrials	0.09	70,570
Information Technology	2.02	3,681,731
Multinational Fixed Income	0.00	96,761
Non-U.S. Corporate	4.69	56,196,679
Non-U.S. FHLM/FNMA	0.64	5,907,576
Non-U.S. Government issues	3.89	39,984,095
Telecommunication Services	1.79	4,444,481
TIPS (Treasury Inflation Protected)	9.03	5,186,383
U.S. Convertibles	9.91	3,845,669
U.S. Fixed Income Funds	0.00	3,319,285
U.S. Private Placements	16.39	98,620,409
U.S. Taxable Muni Bonds	37.95	2,495,043
Utilities	0.37	624,500
Total fixed income securities		$ 954,752,944

Credit risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The HFRRF does not have a formal policy limiting investment credit risk, but rather mandates such limits within the Investment Management Services Contract.

The HFRRF's exposure to investment credit risk in fixed income securities as of June 30, 2008 is as follows:

Quality Rating	Fair Value	Percentage of Holdings
Agency	5,907,576	0.20 %
A1	94,589,819	3.14 %
A2	116,451,188	3.86 %
A3	109,638,775	3.64 %
AA1	32,404,398	1.08 %
AA2	16,452,293	0.55 %
AA3	97,538,656	3.24 %
AAA	158,287,362	5.25 %
B1	28,805,555	0.96 %
B2	20,439,080	0.68 %
B3	16,952,143	0.56 %
Ba1	19,934,638	0.66 %
Ba2	12,032,818	0.40 %
Ba3	19,487,995	0.65 %
Baa1	32,672,493	1.08 %
Baa2	41,812,253	1.39 %
Baa3	51,509,348	1.71 %
C	1,412,140	0.05 %
Caa1	13,091,498	0.43 %
Caa2	9,428,762	0.31 %
Caa3	3,106,394	0.10 %
Rating not available	20,923,126	0.69 %
Total credit risk debt securities*	$ 922,878,310	30.63 %

*Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and therefore, have not been included in this disclosure.

Foreign currency risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. Realized and unrealized gains and losses on investments which result from changes in foreign currency exchange rates have been included in the net appreciation in fair value of investments. The HFRRF's policy allows external investment managers to decide what action to take regarding their respective portfolio's foreign currency exposures subject to compliance with its respective Investment Management Services Contract and the Fund's Investment Policy Statement. The HFRRF's exposure to foreign currency fluctuation as of June as of June 30, 2008 is as follows:

		Fair Value	Percentage of Holdings
EURO Currency	$	157,017,156	5.21 %
British Pound Sterling		94,981,641	3.15 %
Japanese Yen		74,323,972	2.47 %
Swiss Franc		55,984,586	1.86 %
Canadian Dollar		32,860,853	1.09 %
Australian Dollar		30,897,887	1.03 %
Singapore Dollar		20,482,341	0.68 %
Brazil Real		17,427,273	0.58 %
Norwegian Krone		13,825,913	0.46 %
Mexican New Peso		11,818,493	0.39 %
Hong Kong Dollar		11,100,002	0.37 %
Thailand Baht		10,036,192	0.33 %
New Zealand Dollar		9,832,019	0.33 %
Indonesian Rupian		9,185,359	0.30 %
South Korean Won		7,975,074	0.26 %
Iceland Krona		6,411,715	0.21 %
Danish Krone		5,036,284	0.17 %
New Taiwan Dollar		4,772,503	0.16 %
Czech Moruna		3,104,554	0.10 %
Swedish Krona		2,328,319	0.08 %
South African Comm Rand		2,154,166	0.07 %
Israeli Shekel		2,053,178	0.07 %
Egyptian Pound		1,271,596	0.04 %
New Turkish Lira		887,030	0.03 %
Chinese Yuan Renminbi		3,236	0.00 %
Hungarian Forint		161	0.00 %
Total securities subject to foreign currency risk	$	585,771,503	19.44

10. Investments – Houston Police Officers' Pension (HPOP)

Summary of Significant Accounting Policies

Investments. Statutes of the State of Texas authorize the HPOP System to invest surplus funds in a manner provided by the Government Code, Title 8, Subtitle A, Subchapter C. Investments are reported at fair value. Securities traded on national or international exchanges are valued at the last reported sales price at current exchange rates. Investments that do not have an established market value are reported at estimated fair value.

Dividend income is recorded on the ex-dividend date. Income from other investments is recorded when earned. Gains and losses on sales of securities are recognized on the trade date. The cost of investments sold is determined using the first-in, first-out cost flow method. Short-term investments include funds held in the Northern Trust Short Term Investment Fund (STIF) and commercial paper with maturities not exceeding one year. Fixed income investments include government securities such as Treasury securities, Federally sponsored agency issued discount notes, bonds, agency pass-through securities and collateralized mortgage obligations; US corporate bonds such as term bonds and asset backed securities; and foreign securities such as dollar denominated and non-dollar denominated issues of non-US governments and private corporations. Call options on fixed income securities give the holder the right but not the obligation to purchase US Treasury securities during the term of the option contract. The holder pays a premium for this right, which is carried as an asset of the HPOP System, subject to daily mark-to-market adjustments, during the contract term. The issuer of the option has an obligation to the holder to settle the option position in cash at the fair value of the underlying security in exchange for the price specified by the option, until the contract is exercised or expires. Equity securities consist of individual shares of equity securities plus units of commingled stock funds of both US and foreign entities. Alternative investments consist of investments in hedge funds commodities, private equity and a commingled structured beta fund.

Administrative Costs. All administrative costs of the HPOP System are paid from the System's assets.

Federal Income Tax. A favorable determinations that the HPOP System is qualified and exempt from Federal income taxes was received May 26, 2006. The HPOP's Board believes that the System is designed and continues to operate in compliance with the applicable requirements of the Internal Revenue Code.

Use of Estimates. The preparation of the HPOP System's financial statements, in conformity with accounting principles generally accepted in the United States of American, requires management to make significant estimates and assumptions that affect the reported amounts and net plan assets at the date of the financial statements and the actuarial information included in the required supplementary information as of the benefit information date, the changes in the HPOP System's net assets during the reporting period and, when applicable, disclosures of the contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

The HPOP System's investments have been categorized to address deposit and investment risks related to custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

Custodial Credit Risk. Custodial credit risk for deposits is the risk that in the event of a bank failure, the HPOP System's deposits may not be returned to them. The HPOP System considers only demand deposits as cash. As of June 30, 2008, the HPOP System had a balance of $123 thousand on deposit at a financial institution. The Federal Depository Insurance Corporation (FDIC) covered cash on deposit up to $100 thousand at the financial institution. As of June 30, 2008, $23 thousand of the HPOP System's bank balance of $123 thousand was exposed to custodial credit risk. Subsequent to June 30, 2008, the federal government passed legislation that increases FDIC coverage to $250 thousand per account at this financial institution. In addition, at June 30, 2008, the HPOP System has approximately $6,417 thousand on deposit with other financial institutions, which is subject to custodial credit risk, as it is not covered by depository insurance and is uncollateralized.

Credit Risk. Credit risk is the risk that the counterparty will not fulfill its obligations. As of June 30, 2008, the System's fixed income assets that are not government guaranteed represented 64.7% of the HPOP System's fixed income portfolio. The below tables summarize the HPOP System's fixed income portfolio exposure levels and credit qualities.

Average Credit Quality and Exposure Levels of Non-U.S. Government Guaranteed Securities ($000's)

Fixed Income Security Type	Market Value June 30, 2007	Percent of All Fixed Income Assets	Weighted Average Credit Quality
Corporate Bonds	$ 99,604	10.7%	B
International Government Bonds	81,876	8.8%	AA
Mutual Bond Funds	377,601	40.4%	Not Rated
Bank Loans	44,513	4.8%	
Non-Government Backed C.M.O.'s	7	0.0%	
Total	$ 603,601	64.7%	

Ratings Dispersion Detail
(000's)

Credit Rating Level	Corporate Bonds	International Government Bonds	Mutual Bond Funds	Bank Loans	Non-Government Backed C.M.O.s
AAA	$ 549	$ 31,345	$ -	$ -	7
AA	-	34,359	-	-	-
A	1,268	14,261	-	-	-
BBB	1,585	-	-	-	-
BB	34,902	-	-	6,326	-
B	44,576	-	-	15,119	-
CCC	8,409	-	-	-	-
CC	192	-	-	-	-
C	196	-	-	-	-
D	109	-	-	-	-
Not Rated	7,818	1,911	377,601	23,068	-
Total	$ 99,604	$ 81,876	$ 377,601	$ 44,513	$ 7

The HPOP System's investment policy allows Investment managers full discretion in adopting investment strategies to deal with these risks. Unless otherwise provided in the individual investment manager agreement, the average quality rating of each individual fixed income portfolio on a weighted value basis shall be A-rated or higher, and no issue should have a rating below investment grade (Baa or higher). Certain managers, such as high yield managers, may be exempted from these requirements as provided for in their contracts.

Credit risk for derivative instruments held by the HPOP System results from counterparty risk, essentially that the counterparty will be unable to fulfill its obligations, assumed by the HPOP System. Information regarding the HPOP System's credit risk related to derivatives is found under the derivatives disclosures.

Policies regarding credit risk pertaining to credit risk associated with the HPOP System's securities lending program are found under the securities lending disclosures.

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributable to the magnitude of the HPOP System's investment in a single issue. The HPOP System's operational guidelines for each specific portfolio limits investments in any one single domestic equity issue to 15% of each portfolio at market value and for any one single international equity issue to 5% of the HPOP System's investments. For fixed income investments, the HPOP System's policy limits, by each specific portfolio, investment in any one single fixed income security to 10% of each portfolio at market value. As of June 30, 2008, the HPOP System did not have any investments in any one organization which represented greater than 5% of plan net assets.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the HPOP System's financial instruments. This risk is managed within the portfolio using the modified duration methodology. It is widely used in the management of fixed income portfolios and estimates the sensitivity of a bond's price to interest rate changes. All of the HPOP System's fixed income portfolios are managed in accordance with guidelines that are specific as to the degree of interest rate risk taken. The reporting of modified duration found in the tables below quantifies the interest rate risk of the HPOP System's fixed income investments. Interest rate risks associated with derivative instruments are found in the derivatives disclosures of these notes.

Modified Duration of Fixed Income Assets by Security Type
($000's)

Fixed Income Security Type	Market Value June 30, 2008	% of All Fixed Income Assets	Weighted Average Modified Duration (years)
US Treasuries	$ 329,935	35.3%	15.2
Corporate Bonds	99,604	10.7%	4.7
International Government Bonds	81,876	8.8%	6.4
Mutual Bond Funds	377,601	40.4%	5.0
Bank Loans	44,513	4.8%	0.0
Non-Government Backed C.M.O.'s	7	0.0%	0.2
Total	$ 933,536	100.0%	8.4

Modified Duration Analysis - Corporate Bonds, International Government Bonds, Bank Loans and Non-Government Backed C.M.O.'s ($000's)

Corporate Bonds	Market Value June 30, 2008	Average Modified Duration	Contribution Modifed Duration
Less than 1 year to maturity	$ 1,277	0.7	0.0
1 to 10 years maturities	92,704	4.5	4.2
10 to 20 years maturities	4,810	8.5	0.4
Greater than 20 years maturities	813	10.0	0.1
Total	$ 99,604		4.7
International Government Bonds			
Less than 1 year to maturity	$ 299	1.1	0.0
1 to 10 years maturities	56,001	3.5	2.4
10 to 20 years maturities	11,113	11.3	1.5
Greater than 20 years maturities	14,463	14.0	2.5
Total	$ 81,876		6.4
Bank Loans			
Less than 1 year to maturity	$ 485	0.0	0.0
1 to 10 years maturities	44,028	0.0	0.0
Total	$ 44,513		0.0
Non-Government Backed C.M.O.'s			
Greater than 20 years maturities	7	0.2	0.2
Total	$ 7		0.2

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The books and records of the HPOP System are maintained in US dollars. Foreign currencies and non-dollar denominated investments are translated into US dollars at the bid prices of such currencies against US dollars at each balance sheet date. Realized and unrealized gains and losses on investments which result from changes in foreign currency exchange rates have been included in the net appreciation in fair value of investments. Net realized foreign currency gains and losses resulting from changes in exchange rates include foreign currency gains and losses between trade date and settlement date of investment securities transactions, foreign currency transactions and the difference between the amounts of interest and dividends recorded on the books of the HPOP System and the amount actually received.

The HPOP System's exposure to foreign currency risk in U.S. dollars as of June 30, 2008, is shown in the table below:

Foreign Currency Exposure by Asset Class
($000's)

Currency	Short Term Investments	Equities	Fixed Income	Alternative Investments	Options on Foreign Currencies	Total
Australian dollar	$ (38)	$ -	$ -	$ -	$ -	$ (38)
British pound sterling	2	64,770	5,323	-	(5,307)	64,788
Canadian dollar	21	4,646	1,615	-	(1,615)	4,667
Danish krone	-	-	950	-	(953)	(3)
Euro	483	125,098	37,482	18,765	(37,569)	144,259
Hong Kong dollar	-	2,052	-	-	-	2,052
Japanese yen	169	91,372	36,976	-	(37,023)	91,494
New Zealand dollar	-	1,475	-	-	-	1,475
Norwegian krone	-	2,113	-	-	-	2,113
South Korean won	-	3,453	-	-	55	3,508
Swedish krona	55	9,346	401	-	(459)	9,343
Swiss franc	612	13,441	-	-	-	14,053
	$ 1,304	$ 317,766	$ 82,747	$ 18,765	$ (82,871)	$ 337,711

Securities Lending Program – The Board of Trustees' policies permit the HPOP System to lend securities (domestic and international equities and fixed income) to securities firms on a temporary basis through its custodian bank. The HPOP System receives fees for all loans and retains the right to all interest and dividend payments while the securities are on loan. Cash, letters of credit or various government securities having market values equal to or exceeding 102 and 105 percent of the value of the loaned securities for domestic and international securities, respectively, collateralize all security loan agreements. Whenever market value of the securities on loan changes, the borrower must adjust the collateral accordingly. At June 30, 2008, the HPOP System had no credit risk exposure to borrowers because the amounts the System owes the borrowers, $496,426 thousand, exceeds the amounts the borrowers owe the System, $358,938 thousand, as shown in the table below.

	Fair Value ($000's)
June 30, 2008	
Investments held by System's agent in System's name:	
Short-term investments	$ 85,625
Fixed income	666,252
Equities	1,236,238
Alternative investments	968,618
Foreign currency contracts	-
Securities lending collateral investment pool	496,426
	$ 3,453,159
Investments held by brokers under Securities loans with cash collateral:	
Fixed income	$ 267,284
Equities	91,654
	$ 358,938

The HPOP System's bank pools all collateral received from securities lending transactions and invests any cash collateral. The HPOP System holds an undivided share of the collateral provided by the borrowers of the securities. At June 30, 2008 the weighted-average maturity of the collateral pool was 54 days. The relationship between the maturities of the collateral pool and the HPOP System's loans has not been determined. Cash collateral invested in the custodian bank collateral pool at June 30, 2008 was $368,008 thousand. The balance of the collateral at June 30, 2008 was $128,418 thousand, and consists of treasury securities and letters of credit.

The HPOP System cannot sell or pledge the collateral unless the borrower fails to return the securities borrowed. The market value of securities on loan at June 30, 2008 was $483,249 thousand.

Derivatives – The HPOP System's investment managers may invest in derivatives if permitted by the guidelines established by the HPOP System's Board of Trustees. The HPOP System's staff monitors guidelines and compliance. From time to time the HPOP System's investment managers will invest in foreign currency contracts, options, swaps, reverse repurchase agreements, index linked bonds, collateralized mortgage obligations and mortgage-backed securities. No derivatives are purchased with borrowed funds.

These derivative instruments are subject to the following risks:

- *Credit Risk* – The risk that the counterparty will not fulfill its obligations. The HPOP System's investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures.
- *Interest Rate Risk* – The risk that changes in interest rates will adversely affect the fair values of the HPOP System's financial instruments or cash flows.
- *Basis Risk* – The risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes.
- *Termination Risk* – The risk that a derivative's unscheduled end will adversely affect an investment manager's strategy.
- *Rollover Risk* – The risk that a derivative associated with the HPOP System's fixed income investments does not extend to the maturity of those investments.

Foreign currency contracts are used to hedge against the currency risk in the HPOP System's investments in foreign equity and fixed income securities and also as part of a total return strategy that seeks absolute returns from relative changes in the prices of foreign currencies. The other derivatives are used to enhance yields and provide incremental income.

Futures on investments are used to take advantage of mis-pricing opportunities. When a position is taken in a futures contract, a margin is posted and the contract is subject to daily mark-to-market adjustments. To liquidate the contract prior to expiration an offsetting position in the same contract must be taken. At expiration the holder of the futures contract accepts delivery of the underlying asset at the agreed-upon price**.**

The average futures balance outstanding, not including foreign currency contracts, during the fiscal year ending June 30, 2008 was $103,745 thousand. Futures outstanding, not including foreign currency contracts at June 30, 2008 was $131,156 thousand.

The contract or notional amounts of these instruments reflect the extent of the HPOP System's involvement in each class of financial instrument as of June 30, 2008 as follows *(in thousands)*:

Description	Contract	Notional Value	Exposure
Futures on Treasury Bills and Equivalents	7	$ 4,208	$ (33)
Commodity Futures	20	82,634	82,634
Equity Futures	4	48,834	(1,964)
Fixed Income Futures	12	55,204	209
Long foreign currency contracts	80	180,893	638
Short foreign currency contracts	80	(181,205)	(951)
Total		$ 190,568	$ 80,533

Alternative Investments – As of June 30, 2008 the HPOP System was invested in various partnerships, separate accounts and commingled funds across various types of alternative investments as detailed in the following chart ($000's).

	Fair Value ($000's)
Investment Type	**2008**
Private Equity	
Leveraged Buyouts	$ 111,459
Special Situations	99,656
Venture Capital	77,407
Other Alternatives	
Hedge Funds	236,114
Real Estate	4,415
Structured Beta	356,627
Commodities	82,940
	$ 968,618

Note 4: Allowance for Doubtful Accounts

The following were the allowances for doubtful accounts receivable by fund as of June 30, 2008 (000's):

Fund	Amount
General	
Uncollectible general property taxes	$ 50,382
Ambulance charges	272,821
Fines and forfeits	28,817
Demolition liens	76,928
Others	4,231
Grant revenue	37,324
Airport System	1,984
Convention and Entertainment Facilities	
Accounts receivable	674
Hotel occupancy tax	174
Combined Utility System	94,405
	$ 567,740

Note 5: Property Tax

The City's annual ad valorem property tax is required to be levied by October 1, or as soon thereafter as practicable, on the assessed value listed as of the prior January 1 for all real and certain personal property. Taxes are due on January 31 of the year following the year of the levy. A tax lien attaches to all property on January 1 of each year to secure the payment of all taxes, penalties and interest that is ultimately imposed on the property. The tax rate established by the City Council for the 2007 tax year was $0.643750 per $100 of assessed value with $0.461975 for operations and $0.181775 for debt service.

The City Charter limits the property tax rate to $0.50 per $100 of assessed valuation excluding taxes levied for "debt service," as that term is defined in Section 1 of Article III of the City Charter. The Texas Property Tax Code ("Code"), with certain exceptions, exempts intangible personal property, household goods, and family-owned automobiles from taxation. In addition, the Code provides for countywide appraisal districts.

Note 6: Capital Assets

A. Governmental activities of the Primary Government

A summary of changes in capital assets for the year ended June 30, 2008 follows (in thousands):

	Balance July 1, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
Primary Government					
Capital assets not being depreciated:					
Land	$ 298,507	$ 6,070	$ (13)	$ 22,731	$ 327,295
Right of way	1,689,296	8,535	(2,089)	6,016	1,701,758
Construction Work in Progress	376,904	309,795	-	(273,086)	413,613
Total capital assets not being depreciated	2,364,707	324,400	(2,102)	(244,339)	2,442,666
Other capital assets:					
Buildings	641,426	371	(2,944)	53,874	692,727
Improvements and Equipment	674,927	44,038	(22,681)	6,734	703,018
Infrastructure	4,915,169	7,794	(2,730)	175,386	5,095,619
Total other capital assets	6,231,522	52,203	(28,355)	235,994	6,491,364
Less accumulated depreciation for:					
Buildings	(194,658)	(15,804)	624	821	(209,017)
Improvements and Equipment	(443,781)	(41,652)	22,152	561	(462,720)
Infrastructure	(2,094,836)	(110,174)	2,062	-	(2,202,948)
Total accumulated depreciation	(2,733,275)	(167,630)	24,838	1,382	(2,874,685)
Other capital assets, net	3,498,247	(115,427)	(3,517)	237,376	3,616,679
Primary Government capital assets, net	$ 5,862,954	$ 208,973	$ (5,619)	$ (6,963)	$ 6,059,345

B. Business-type Activities

	Balance July 1, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
Airport System					
Capital assets not being depreciated:					
Land	$ 202,214	$ -	$ -	$ 5,225	$ 207,439
Construction Work in Progress	302,189	141,457	-	(207,556)	236,090
Total capital assets not being depreciated	504,403	141,457	-	(202,331)	443,529
Other capital assets:					
Buildings	1,807,690	7,329	-	65,790	1,880,809
Improvements and equipment	1,719,672	5,572	(942)	136,541	1,860,843
Total other capital assets	3,527,362	12,901	(942)	202,331	3,741,652
Less accumulated depreciation for:					
Buildings	(433,461)	(63,516)	-	-	(496,977)
Improvements and equipment	(769,575)	(62,435)	905	-	(831,105)
Total accumulated depreciation	(1,203,036)	(125,951)	905	-	(1,328,082)
Other capital assets, net	2,324,326	(113,050)	(37)	202,331	2,413,570
Airport System capital assets, net	2,828,729	28,407	(37)	-	2,857,099
Convention and Entertainment Facilities					
Capital assets not being depreciated:					
Land	99,757	-		-	99,757
Construction Work in Progress	753	1,699	-	(603)	1,849
Total capital assets not being depreciated	100,510	1,699	-	(603)	101,606
Other capital assets:					
Buildings	444,788	266	-	2,218	447,272
Garage Rights	13,144	-	-	-	13,144
Improvements and equipment	7,979	889	(26)	100	8,942
Infrastructure	110	-	-	-	110
Total other capital assets	466,021	1,155	(26)	2,318	469,468
Less accumulated depreciation/amortization for:					
Buildings	(138,320)	(11,304)	-	(645)	(150,269)
Garage Rights	(1,224)	(353)	-	-	(1,577)
Improvements and equipment	(5,394)	(423)	26	(189)	(5,980)
Infrastructure	(9)	(4)	-	-	(13)
Total accumulated depreciation/amortization	(144,947)	(12,084)	26	(834)	(157,839)
Other capital assets, net	321,074	(10,929)	-	1,484	311,629
Convention and Entertainment Facilities capital assets, net	421,584	(9,230)	-	881	413,235

	Balance July 1, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
Combined Utility System					
Capital assets not being depreciated:					
Land	101,371	12,141	(2,006)	3,972	115,478
Construction Work in Progress	507,292	359,868	-	(453,550)	413,610
Total capital assets not being depreciated	608,663	372,009	(2,006)	(449,578)	529,088
Other capital assets:					
Buildings	97,657	8	(5,592)	3,234	95,307
Improvements and equipment	101,076	9,482	(3,236)	2,050	109,372
Infrastructure	7,619,503	25,077	(66,051)	475,265	8,053,794
Water Rights	456,915	-	-	-	456,915
Total other capital assets	8,275,151	34,567	(74,879)	480,549	8,715,388
Less accumulated depreciation/amortization for:					
Buildings	(43,047)	(2,861)	4,072	-	(41,836)
Improvements and equipment	(66,632)	(6,499)	3,112	(263)	(70,282)
Infrastructure	(3,674,862)	(199,352)	43,408	(1,681)	(3,832,487)
Water Rights	(254,320)	(11,432)	-	-	(265,752)
Total accumulated depreciation/amortization	(4,038,861)	(220,144)	50,592	(1,944)	(4,210,357)
Other capital assets, net	4,236,290	(185,577)	(24,287)	478,605	4,505,031
Combined Utility System capital assets, net	4,844,953	186,432	(26,293)	29,027	5,034,119
Combining Non-Major Enterprise Funds					
Capital assets not being depreciated:					
Land	2,856	-	-	(2,856)	-
Construction Work in Progress	213	257	-	-	470
Total capital assets not being depreciated	3,069	257	-	(2,856)	470
Other capital assets:					
Buildings and Improvements	24,817	44	-	(5,112)	19,749
Equipment	-	132	-	470	602
Plants and Lines	138,439	-		(16,844)	121,595
Total other capital assets	163,256	176	-	(21,486)	141,946
Less accumulated depreciation for:					
Buildings and Improvements	(762)	(439)	-	-	(1,201)
Equipment	-	(12)	-	(284)	(296)
Plants and Lines	(7,902)	(4,229)		1,680	(10,451)
Total accumulated depreciation	(8,664)	(4,680)	-	1,396	(11,948)
Other capital assets, net	154,592	(4,504)	-	(20,090)	129,998
Combining Non-Major Enterprise Funds, net	157,661	(4,247)	-	(22,946)	130,468
Business-type activities capital assets, net	$ 8,252,927	$ 201,362	$ (26,330)	$ 6,962	$ 8,434,921

Included in the transfers are assets of $1,787 thousand contributed to the Combined Utility System Fund, $881 to the Convention & Entertainment Facility Fund, and $4,295 to the Parking Management Fund from the General Fund.

C. Depreciation Expense

Depreciation expense was charged to functions/ programs of the primary government as follows (in thousands):

Governmental activities		
General government	$	7,175
Public safety		25,055
Public works		12,039
Health		2,689
Housing		378
Parks and recreation		8,273
Library		1,847
Infrastructure		110,174
Total depreciation expense - governmental activities	$	167,630
Business-type activities		
Airport System	$	125,951
Convention & Entertainment Facilities		12,084
Combined Utility System		219,938
Nonmajor Business-type		4,636
Total depreciation expense - business-type activities	$	362,609

D. Pension Trust Funds

In February 1998, the Firefighters' Relief and Retirement Fund purchased land in the amount of $483,325 for use in the construction of a new office building for its operations and its members. In April of 2001, the construction of the new building was completed. The building cost of $9,140,824 is being depreciated over 30 years. The accumulated depreciation for the building as of June 30, 2008 amounted to $2,225,090.

Note 7: Short-Term Debt – Tax and Revenue Anticipation Notes

Short-term debt activity for the year ended June 30, 2008, was as follows (amounts in thousands):

	Balance July 1, 2007	Issued	Redeemed	Balance June 30, 2008
Tax and revenue Anticipation notes	$ -	$ 115,000	$ 115,000	$ -

On July 2, 2007, the City closed on the sale of $115,000,000 Tax and Revenue Anticipation Notes ("TRANS"), Series 2007. The proceeds of the TRANS were used to pay working capital expenditures until tax revenues were received. The stated interest rate was 4.5%, and the average yield was 3.70%. The notes matured on June 30, 2008.

Note 8: Long-Term Liabilities

A. General Long-Term Liabilities

Changes in General Long-Term Liabilities for the year ended June 30, 2008 are summarized as follows (in thousands):

	Balance July 1, 2007	Additions	Retirements/ Transfers	Balance June 30, 2008	Amounts Due within One Year
Governmental Activities					
Bonds and notes payable					
General tax obligation debt	$ 2,782,083	$ 622,784	$ (422,041)	$ 2,982,826	$ 174,868
Accretions, net	2,113	373	(6)	2,480	-
HUD Section 108 Loans	20,200	-	(5,140)	15,060	1,745
Deferred charges for electricity	2,941	-	(1,426)	1,515	1,515
Plus premium on bonds	86,580	9,004	(6,390)	89,194	-
Less deferred amount on refundings	(18,829)	-	2,248	(16,581)	-
Total bonds and notes payable	2,875,088	632,161	(432,755)	3,074,494	178,128
Other liabilities:					
Claims and judgments	133,390	26,053	(17,074)	142,369	21,313
Compensated absences	376,962	111,865	(88,514)	400,313	130,852
Arbitrage rebate	179	78	(15)	242	-
Other Post Retirement Benefit liability	-	285,715	(46,093)	239,622	-
Pension liability	467,422	263,412	(169,069)	561,765	-
Total other liabilities	977,953	687,123	(320,765)	1,344,311	152,165
Governmental Activities Long-Term Liabilities	$ 3,853,041	$ 1,319,284	$ (753,520)	$ 4,418,805	$ 330,293
Discretely Presented Component Units:					
Notes payable	$ 340,187	$ 18,934	$ (20,213)	$ 338,908	$ 15,640
Revenue bonds	141,848	10,000	(5,763)	146,085	5,940
Discretely Presented Component Units Long-Term Liabilities	$ 482,035	$ 28,934	$ (25,976)	$ 484,993	$ 21,580

(Continued)

	Balance July 1, 2007	Additions	Retirements/ Transfers	Balance June 30, 2008	Amounts Due within One Year
Business-type activities					
Bonds and notes payable					
Airport System debt	$ 2,302,986	$ 329,670	$ (336,845)	$ 2,295,811	$ 46,930
Convention and Entertainment debt	618,264	8,300	(17,540)	609,024	18,620
Combined Utility System debt	4,819,076	2,215,275	(1,907,263)	5,127,088	37,683
Deferred charges for electricity	7,518	-	(3,642)	3,876	3,876
Houston Area Water Corporation	125,410	-	(125,410)	-	-
Long-term contracts - Combined Utility	230,008	-	(21,567)	208,441	18,255
Premiums, discounts and deferred amount on refundings	96,385	61,684	(24,428)	133,641	-
Total bonds and notes payable	8,199,647	2,614,929	(2,436,695)	8,377,881	125,364
Other liabilities:					
Claims and judgments	6,914	3,319	(2,517)	7,716	2,517
Compensated absences	26,926	23,149	(18,797)	31,278	12,194
Arbitrage rebate	2,662	2,520	-	5,182	-
OPEB liability	-	40,803	(8,384)	32,419	-
Pension liability	75,006	29,555	(22,912)	81,649	-
Deferred Revenue	168,722	116,475	-	285,197	-
Total other liabilities	280,230	215,821	(52,610)	443,441	14,711
Business-type activities Long-Term Liabilities	$ 8,479,877	$ 2,830,750	$ (2,489,305)	$ 8,821,322	$ 140,075
Total Reporting Entity Long-Term Liabilities	$ 12,814,953	$ 4,178,968	$ (3,268,801)	$ 13,725,120	$ 491,948

B. Schedule of Changes in Bonds and Long-Term contracts (amounts expressed in thousands):

	Stated Interest Rate Range	Face Value Outstanding 7/1/2007	FY08 Issued/ Increased
General Tax Obligation Debt			
Public improvement bonds	3.00 to 5.75	1,760,090	219,660
Pension obligations	3.35 to 8.50	420,656	51,549
Commercial paper	1.81 to 10.00	521,100	343,000
Tax and revenue certificates of obligation	3.00 to 6.00	80,237	8,575
Deferred Electricity Note	5.26	2,941	-
Total General Tax Obligation Debt		$ 2,785,024	$ 622,784
HUD Section 108 Loans		$ 20,200	$ -
Revenue Bonded Debt			
Airport System Bonds			
Subordinate lien refunding revenue bonds	1.78 to 6.00	$ 2,117,820	$ 298,670
Senior lien commercial paper	1.91 to 10.00	95,000	31,000
Inferior lien contractual obligation	5.38 to 5.50	53,360	-
Pension obligations	5.31 to 8.50	36,806	-
Deferred Electricity Note	5.26	1,961	-
		2,304,947	329,670
Convention and Entertainment Facilities			
Senior lien hotel occupancy tax/parking facilities	3.22 to 5.75	579,275	-
Hotel and parking revenue commercial paper	1.94 to 10.00	35,500	8,300
Pension obligations	5.31 to 8.50	3,489	-
Deferred Electricity Note	5.26	494	-
		618,758	8,300
Combined Utility System			
Combined Utility System first lien bonds	1.96 to 5.40	3,537,080	1,995,275
Water and Sewer System junior lien revenue bond	1.00 to 6.90	786,814	-
Combined Utility System commercial paper	1.98 to 10.00	440,200	220,000
Pension obligations	5.31 to 8.50	54,982	-
Deferred Electricity Note	5.26	5,063	
		4,824,139	2,215,275
Houston Area Water Corporation	--	125,410	-
Long-Term Contracts-Water and Sewer System			
Coastal Water Authority	2.50 to 7.50	204,115	-
Trinity River Authority	--	2,000	-
Other long term contracts	3.22 to 5.87	23,893	-
		230,008	-
Total Revenue Bonded Debt and Long-Term Contracts, Primary Government		$ 8,103,262	$ 2,553,245
Total Bonds and Long-Term Contracts Payable, Primary Government		$ 10,908,486	$ 3,176,029

(Continued)

1) Adjustments consist of unamortized bond premiums, discounts, deferred (gains) losses from bond refundings and capital appreciation bond accretions.

FY08 Redeemed/Refunded	Face Value Outstanding 6/30/08	Adjustments[1]	Net Outstanding 6/30/2008
181,600	1,798,150	70,353	1,868,503
-	472,205	-	472,205
238,150	625,950	-	625,950
2,291	86,521	4,742	91,263
1,426	1,515	-	1,515
$ 423,467	$ 2,984,341	$ 75,095	$ 3,059,436
$ 5,140	$ 15,060	$ -	$ 15,060
$ 290,185	$ 2,126,305	$ (32,135)	$ 2,094,170
43,000	83,000	-	83,000
3,660	49,700	-	49,700
-	36,806	-	36,806
950	1,011	-	1,011
337,795	2,296,822	(32,135)	2,264,687
17,540	561,735	62,824	624,559
-	43,800	-	43,800
-	3,489	-	3,489
239	255	-	255
17,779	609,279	62,824	672,103
1,386,950	4,145,405	(66,189)	4,079,216
16,613	770,201	166,566	936,767
503,700	156,500	-	156,500
-	54,982	-	54,982
2,453	2,610	-	2,610
1,909,716	5,129,698	100,377	5,230,075
125,410	-	-	-
19,470	184,645	(1,804)	182,841
2,000	-	-	-
97	23,796	4,379	28,175
21,567	208,441	2,575	211,016
$ 2,412,267	$ 8,244,240	$ 133,641	$ 8,377,881
$ 2,840,874	$ 11,243,641	$ 208,736	$ 11,452,377

C. Terms of Long-Term Debt

1. Public Improvement Bonds

The City has issued Public Improvement Bonds on numerous occasions. The bonds are payable from ad valorem tax revenues. The proceeds are used for street and bridge improvements, traffic signals, municipal buildings, parks, and other capital improvements. Interest is payable semi-annually; principal is payable in various amounts annually through March 1, 2037.

2. Pension Obligation Bonds

The City has issued General Obligation Taxable Pension Bonds and a Collateralized Pension Obligation Note. The proceeds were used to reduce the unfunded actuarial accrued liability of the Houston Municipal Employees Pension System and the Houston Police Officers Pension System. Interest is payable semi-annually, and principal is payable in varying amounts through 2037. Although these obligations have an ad valorem tax pledge, a portion of the liabilities is recorded in the enterprise funds because the liabilities are directly related and expected to be paid from those funds based on percentages of payroll.

3. General Obligation Swap Agreements

On February 20, 2004 the City entered into a basis swap referred to as a synthetic reduced variance coupon swap with RFPC, LLC ("RFPC").

Objective. The objective of the swap is for the City to reduce its fixed rate debt service costs through a swap structure that takes on basis risk.

Terms. The notional principal value of the swap is $200,000,000, with the underlying bonds being various maturities of PIBS issued between 1998 and 2005. The City pays an amount equal to 5% plus the tax-exempt market standard SIFMA Index rate divided by .667 minus the taxable six-month US Dollar LIBOR rate minus a constant of 67.5 basis points (adjusted for day count), up to a maximum of 10%. The City receives a fixed rate of 5%. Because the two 5% fixed rates offset one another, the City is effectively making variable payments based on SIFMA and receiving variable payments based on LIBOR plus a fixed spread. The variable rate is fixed for each budget period. The agreement is effective from March 1, 2004 to March 1, 2025. Starting in fiscal year 2017, the notional value of the swap declines as the principal amount of the associated debt is repaid in varying amounts until the debt is retired in 2023. Payments will be received or made every six months based on the indices for the prior budget period.

As of June 30, 2008 the swap created synthetic variable-rate exposure as follows:

	TERMS	RATE (%)
Variable rate payment to counterparty	Fixed Rate	5.000
	SIFMA/0.667	2.927
	-LIBOR	(3.017)
	-Constant	(0.675)
Net payment to counterparty		4.235
Receipt from counterparty	Fixed	(5.000)
Net interest rate swap payment/(receipt)		(0.765)
Fixed rate bond coupon payments		5.128
Synthetic variable interest rate on bonds		4.363

Fair value. The fair value of the swap was $1,800,000 as of June 30, 2008. The value was calculated using the zero coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These net payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit risk. The City is exposed to credit risk on the swap in the amount of its fair value. RFPC, the swap counterparty, has not been rated by the rating agencies. To mitigate this potential credit risk for an unrated counterparty, the City RFPC to purchase a surety bond from Ambac Assurance Corporation (Ambac"), a AA-rated insurance company. Under the surety bond, Ambac is unconditionally and irrevocably obligated to guarantee all payments under the swap by the counterparty. The City's obligations under the swap are also insured. Should Ambac's ratings decline in the future, the counterparty will be required to post collateral for the City's benefit.

Interest rate risk. The City has an exposure to interest rate risk because it is paying a variable rate on the swap. However, this risk is mitigated because the payment formula has a SIFMA-based variable component that is offset by subtracting a LIBOR variable component.

Basis risk. The City is exposed to basis risk based on changes in the relationship between the SIFMA Index and six-month US Dollar LIBOR. The City entered into the swap in anticipation of savings that would be produced based on the historical trading patterns of SIFMA and LIBOR in different interest rate, tax, and economic environments over the past two decades. If, however, future trading patterns prove to be significantly different than historical ones, the City's anticipated savings could fail to materialize, and it could be exposed to additional costs. Among the factors that could cause this trading relationship to change would be a major reduction in marginal income tax rates, repeal of the tax-exemption on municipal bond interest, or other changes in federal policy that would reduce the benefit that municipal bonds currently enjoy in comparison to taxable investments.

Termination risk. The City may terminate the swap for any reason. The counterparty may terminate the swap if both the City and the City's insurer fails to perform under the terms of the contract. If the swap has a negative fair value at the time of termination, the City will be liable to the counterparty for that payment. The City's termination risk is significantly mitigated by a provision in the swap agreement that allows the City to make the termination payment in equal annual installments from time of termination up to termination date of the agreement in 2025.

Swap receipts and associated debt. The City received $1,377,000 during fiscal year 2008. As of June 30, 2008, assuming current interest rates, the City will receive swap payments as reported in Note 8D. Because rates vary, variable rate bond interest payments and net swap receipts or payments will vary. Related debt service payments on the underlying Public Improvement Bonds are included in Note 8D with other City Public Improvement Bonds.

4. General Obligation Commercial Paper

The City currently may issue Commercial Paper Notes ("Notes") under its $500 million General Obligation Commercial Paper Program Series D, its $180 million General Obligation Commercial Paper Program Series E-1, its $145 million General Obligation Commercial Paper Program Series E-2 Program, its $139.5 million General Obligation Commercial Paper Program Series F, and its $276 million General Obligation Commercial Paper Program Series G. General Obligation Commercial Paper Notes Series A and Series B were discontinued on December 4, 2006 when all outstanding Notes for those series were refunded. The Notes may be issued for a period not to exceed 270 days and will bear interest based upon the specified term of the Notes, but not to exceed 10%. Principal on the Notes is payable from ad valorem tax revenue, the issuance of new commercial paper, bond proceeds and other funds provided under credit lines. Interest is payable as the Notes mature from ad valorem tax revenue collected by the City. Proceeds from the Notes are used to finance various capital projects and public improvements for authorized City purposes. Upon maturity, the Notes will be remarketed by the commercial paper dealers or extinguished with long-term debt.

During fiscal year 2008 the average interest rate for the General Obligation Notes, including dealer and credit fees, was 2.53%. The average year-end rate, including fees, was 1.81%. The Credit Agreements expire on the following dates: Series D on May 25, 2010, Series E-1 on April 29, 2011, Series E-2 on April 29, 2011, Series F on May 25, 2010, and Series G on November 15, 2011.

5. Certificates of Obligation

Since 1988, the City has issued Certificates of Obligation each year to provide for the purchase of equipment utilized in general City operations including, without limitation, police vehicles, maintenance vehicles and equipment, computer equipment, and costs associated with demolishing dangerous structures. Each year the City is obligated to levy, assess, and collect ad valorem taxes sufficient to pay principal and interest on the certificates payable semi-annually until maturity. Generally, these certificates are not subject to redemption prior to final maturity, except for the Certificates of Obligation Series 2005D which are subject to optional redemption on or after March 1, 2015.

6. HUD Section 108 Loan

The City has borrowed money from the United States Department of Housing and Urban Development ("HUD") and loaned it to the Houston Business Development Initiative ("HBDI") and three hotels in the downtown business district. HBDI in turn makes small business loans to under-served areas of the community. The City has pledged only certain grant revenues and its receipts from the loans to repay HUD.

7. Airport System Revenue Bonds

These funds are paid solely from a lien on the airport system's net revenues, which must total 110% of the debt service requirements for Subordinate Lien Bonds for such fiscal year. The bonds have a final maturity in the year 2032.

Airport System Subordinate Lien Revenue Bonds, Series 2000P1 and 2001P2, 2002C, 2002D-1, and 2002D-2, have been issued as auction rate securities with current 7-day resets. Series 2005A has been issued as Variable Rate Demand Obligations with a 7-day reset. These bonds may all be converted to other modes including fixed rate bonds. The City has a liquidity facility in place for the Series 2005A bonds with a termination date of July 1, 2010. The maximum interest rate permitted under the ordinance is 10%.

The City has purchased municipal debt service reserve fund policies that unconditionally guarantee the payment of principal and interest on all current outstanding airport system subordinate lien issues. The reserve policies terminate upon final maturities on various dates in the future. Each of the draws made against the reserve policy shall bear interest at the Prime Rate plus two percent, not to exceed a maximum interest rate of 12%. The repayment provisions require one-twelfth of the policy costs for each draw to be repaid monthly, beginning the first month following the date of each draw.

8. Airport System Inferior Lien Contract

On July 1, 2004 the City and Continental Airlines, Inc. entered into a Sublease Agreement associated with the Special Facilities Lease for the Automated People Mover System and the City's Airport System Special Facilities Revenue Bonds (Automated People Mover Project) Series 1997A ("1997A Special Facilities Bonds"). The City assumed Continental's interest in the project upon completion of the expansion of the Automated People Mover System on January 25, 2005. As part of the Sublease, the City agreed to make sublease payments that include amounts equal to the debt service on the 1997A Special Facilities Bonds. The payments are payable from Airport system net revenues on the same priority as inferior lien bonds. Accordingly, the principal amount remaining on the 1997A Special Facilities Bonds, totaling $49,700,000, is recorded as an Inferior Lien Contract.

9. Airport System Commercial Paper

Airport System Senior Lien Commercial Paper Notes Series A and B (the "Notes") have been authorized for $150 million, and Airport System Inferior Lien Commercial Paper Notes Series C have been authorized for $150 million to establish, improve, enlarge, extend and repair the City's Airport System, acquire land, and pay interest and cost of issuance of the Notes. During fiscal year 2008 the average interest rate for the Airport System Notes, including dealer and credit fees, was 2.88%. The average year-end rate, including fees, was 1.91%.

The Series A and B Notes are collateralized by a revolving credit agreement convertible to direct pay letters of credit issued by a bank, and a lien on the net revenues of the Airport System. The Letter of Credit will terminate on January 4, 2011 for Series A and B.

The Fund has pledged airport system revenues, net of operation and maintenance expenses, to pay principal and interest on outstanding Senior Lien Commercial Paper Notes, Subordinate Lien Revenue Bonds, and an Inferior Lien Contract, with outstanding principal amounts of $83,000,000, $2,126,305,000 and $49,700,000, respectively. The Commercial Paper Notes and Revenue Bonds are issued to establish, improve, enlarge, extend and repair the Airport System. The Inferior Lien Sublease Agreement with Continental Airlines pays debt service on the Airport System Special Facilities Bonds (Automated People Mover Project) Series 1997A.

Pledged airport system revenues exclude: proceeds of any bonds, replacement proceeds, or any investment income earned by bond proceeds; passenger facility charges; grants or gifts for construction or acquisition; insurance proceeds; revenue from special facilities pledged to Special Facility Bonds; taxes collected for others; and proceeds from the sale of property. Pledged airport system revenues, net of operation and maintenance expense, totaled $256,113,000 in Fiscal Year 2008, covering principal of $45,996,000 and interest of $111,623,000. In addition to pledged airport system revenue, grants and passenger facility charges totaling $28,022,000 were available to cover debt service in Fiscal Year 2008, making the ratio of net pledged revenue to reduced debt service cost 198%.

10. Convention and Entertainment Facilities Bonds

These bonds are special limited obligations of the City that are paid from a lien on the pledged receipts of the Hotel Occupancy Tax (HOT), revenues collected from six City-owned parking facilities, and rebates of certain taxes derived from operation of the Convention Center Hotel and Parking Garage. Proceeds of the bonds were used to refund the Series 1995 Senior Lien Hotel Occupancy Tax Revenue Bonds and commercial paper notes and to fund expansion of the George R. Brown Convention Center, a new convention center hotel, and a parking garage The pledged HOT receipts are equal to 5.65% of the cost of substantially all hotel room rentals in the City, plus related penalties and interest for delinquent payments. Pledged revenues consisted of $53.4 million generated from $944 million of taxable hotel rentals, related penalties and interest; $9.8 million of parking revenues; and $6.4 million of tax rebates. Revenues are pledged to bonds until their final maturity in September 2033. In FY08, pledged revenues of $69.6 million were used to pay principal and interest requirements of $41.5 million. As long as any of the Senior Lien Bonds remain outstanding, the City is required to levy a Hotel Occupancy Tax at a rate not less than 7%. The City currently levies a Hotel Occupancy Tax at the rate of 7%.

The City has obtained a debt service reserve insurance policy for the Senior Lien Hotel Occupancy Tax Revenue Bonds. In addition to purchasing the surety policy, the City funded a cash reserve to ensure payment of the maximum annual debt service of the Bonds. The surety policy expires upon final maturity of all outstanding Bonds, September 1, 2033.

The City of Houston Convention Center Revenue Bonds, Series 2001C-1 and 2002C-2, have been issued as 7-day auction rate securities and are subject to conversion at the option of the City and subject to certain restrictions, to bonds that bear interest at rates other than auction rates. The maximum interest rate permitted under the ordinance is 10%.

11. Convention and Entertainment Hotel and Parking Revenue Commercial Paper

Hotel Occupancy Tax and Parking Revenue Commercial Paper Notes Series A have been authorized for $75 million to finance the costs of site acquisition, construction, and improvements for convention center facilities. The notes are issued as subordinate lien debt. The maturity of the Notes may not exceed 270 days and the maximum interest rate may not exceed 10%. Upon maturity, the Notes will be remarketed by the commercial paper dealer or extinguished with long-term debt. The Notes are collateralized by a Letter of Credit that expires on January 16, 2011. During fiscal year 2008 the average interest rate for the Notes, including fees, was 2.80%. The average rate in effect at year-end was 1.94%.

12. Combined Utility System First Lien Revenue Bonds

City Council authorized creation of the Combined Utility System ("the System") on September 3, 2003. The Combined Utility System currently consists of the City's Water and Sewer System. In the future the City may elect to include other utility systems. Its bonds are special obligations of the City payable from Net Revenues of the System after payments for maintenance and operations and debt service on Water and Sewer Junior Lien bonds. Net Revenues must equal 110% of the First Lien Revenue Bonds debt service.

The Combined Utility System Revenue Refunding Bonds, Series 2004B and 2004C, were initially issued as 7-day, 28-day, and 35-day Auction Rate Securities. All of the 2004B auction rate securities were converted to variable rate demand bonds in April 2008. The Combined utility System Revenue Refunding bonds 2008A were issued as tax-exempt variable rate demand bonds to refund $249M of the 2004C tax-exempt auction rate securities, and the Combined Utility System Revenue Refunding Bonds 2008D were issued as taxable variable rate bonds to refund $200M of the 2004C taxable auction rate as securities. The remainder of the 2004C auction rate securities were converted to put bonds that mature on May 15, 2011.

13. Combined Utility System Commercial Paper

The Combined Utility System Commercial Paper Notes Program Series A has been authorized for $900 million to finance costs of eligible projects for the City's combined utility system, including acquisition or construction of improvements and additions or extension for the system, and costs of issuance. The notes are issued as third lien obligations. The maturity of the Notes may not exceed 270 days and the maximum interest rate may not exceed 10%. Principal on the Notes is payable from the issuance of new commercial paper, bond proceeds and other funds provided under the line of credit available through a revolving credit agreement with four banks. The agreement expires on December 15, 2015. Interest on the Notes is payable from net revenues of the System and loans under the credit agreement. During fiscal year 2008 the average interest rate for the Notes, including credit and dealer fees, was 2.47%. The rate in effect at year-end was 1.984%.

14. Combined Utility System Synthetic Fixed Rate Swap Agreements

Combined Utility System synthetic fixed rate swaps. On June 10, 2004 the City entered into three identical pay-fixed, receive-variable rate swap agreements. The City pre-qualified six firms to submit competitive bids on the swap. The bidding took place on June 7, 2004. The three firms selected all matched the lowest fixed rate bid of 3.7784%.

Objective. The objective of the swaps is to hedge against the potential of rising interest rates in conjunction with the City's Combined Utility System 2004B auction rate variable interest bonds ("2004B Bonds") and to achieve a lower fixed rate than the market rate for traditional fixed rate debt at time of issuance of the 2004B Bonds. The City's goal is that its variable receipts under these swaps equal the variable payments made on the bonds, leaving the fixed payment on the swap, plus dealer and liquidity fees, as its net interest.

Terms. The notional amount totals $653,325,000, the principal amount of the associated 2004B Bonds. The City's swap agreements contain scheduled reductions to outstanding notional amounts that follow anticipated payments of principal of the 2004B Bonds in varying amounts during the years 2028 to 2034.

Under the terms of the swaps, the City will pay a fixed rate of 3.7784% (lower than the rate for fixed rate debt at time of issuance) and receive a floating rate equal to 57.6% of One-Month US Dollar LIBOR plus 37 basis points. All agreements were effective June 10, 2004, the date of issuance of the 2004B Bonds. The termination date is May 15, 2034.

At June 30, 2008, the effective rate on the bonds associated with the swap was computed as follows:

	TERMS	RATE (%) Received (Paid)
Variable rate payment from counterparties	LIBOR x 57.6%	1.4234
	+ Constant	0.3700
Swap receipt		1.7934
Fixed rate paid to counterparties	Fixed	(3.7784)
Net rate (paid)/received for swap		(1.9850)
Average variable rate on 2004B bonds, year end		(1.5483)
Plus remarketing and liquidity fees on 2004B bonds		(0.4150)
Effective rate of 2004B bonds		(3.9483)

In contrast, the fixed rate the City paid on its Combined Utility System Series 2004A fixed rate bonds, which have a comparable maturity, was 5.08%.

Fair value. Because long-term interest rates have changed since inception of the swaps, the swaps had a negative fair value of $50,700,000 on June 30, 2008. This value was calculated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These net payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit risk. As of June 30, 2008, the City was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates increase and the fair value of the swap become positive, the City would be exposed to credit risk on the swap in the amount of its fair value. The City's swap policy generally requires that swap counterparties be rated double-A or better by at least one nationally recognized rating agency. As of June 30, 2008, the ratings of the three swap counterparties all met this standard (see below). Also, under the agreements, if a counterparty's credit rating falls below double-A, collateral must be posted in varying amounts depending on the credit rating. No collateral has been required to date.

COUNTERPARTY	Notional Amount	Fair Value	Counterparty Credit Rating (Moody's /S&P /Fitch)
Goldman Sachs Capital Markets	$ 353,325,000	$ (2,501,000)	Aa3 /AA- /AA-
Bear Stearns Financial Products	150,000,000	(1,061,000)	Aaa/AAA/--
UBS AG	150,000,000	(1,061,000)	Aa1 /AA- /AA-
TOTAL	$ 653,325,000	$ (4,623,000)	

Basis risk. The City is exposed to basis risk on the swaps because the variable payment received is based on an index other than SIFMA. Should the relationship between LIBOR and SIFMA move to convergence (because of reductions in tax rates, for example), the expected cost savings may not be realized. The City has issued tax-exempt variable rate bonds with an average rate of 1.55% (not including remarketing agent and liquidity fees) as of June 30, 2008, whereas the associated LIBOR-based rate of the swap was 1.79%. For the fiscal year, the average rate paid on the auction rate bonds was 3.89%, and the average rate for the swap receipts was 2.81%.

Termination risk. The City may terminate for any reason. A counterparty may terminate a swap if the City fails to perform under the terms of the contract. The City's on-going payment obligations under the swap (and, to a limited extent, its termination payment obligations) are insured, and counterparties cannot terminate so long as the insurer does not fail to perform. If a swap should be terminated, the associated variable-rate bonds would no longer carry synthetic fixed interest rates. Also, if at the time of the termination the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

Remarketing risk. The City faces a risk that the remarketing agent will not be able to sell the variable rate demand bonds at a competitive rate. At times rates vary as investors shift portfolios in and out of the tax-exempt variable rate sector.

Swap payments and associated debt. As of June 30, 2008, debt service requirements for the swap agreements are reported in Note 8D, assuming current interest rates remain the same. As rates vary, variable rate bond interest payments and net swap payments will vary. Expected debt service payments on the associated Combined Utility System 2004B bonds are included with other Combined Utility System Bonds on Note 8D.

15. Combined Utility System Forward Interest Rate Swap

Combined Utility System Forward Starting Swap. On November 1, 2005 the City entered into a forward interest rate swap transaction with RBC Dain Rauscher ("RBC"). The transaction was conducted through a competitive bid process.

Objective. The objective of the swap is to hedge against the potential of rising interest rates associated with its Combined Utility System Series 2008A Bonds ("the 2008A Bonds") and to achieve a lower fixed rate than the market rate for traditional fixed rate debt. This swap was originally assigned to $249.1 million of the 2004C auction rate bonds, which were refunded by the 2008A variable rate demand bonds in May 2008. The City's goal is that its variable receipts under these swaps equal the variable payments made on the bonds, leaving the fixed payment on the swap, plus dealer and liquidity fees, as its net interest cost.

Terms. Under the terms of the contract, the City will pay a fixed rate of 3.761% on a par value of $249,075,000, and it will receive variable payments based on 70% of one-month LIBOR. The City's scheduled net swap payments are insured by Ambac Assurance Corporation.

At June 30, 2008, the effective rate on the bonds associated with the swap was computed as follows:

	Terms	Rate (%) Received (Paid)
Variable rate payment from counterparties	LIBOR x .70	1.7299
Fixed rate paid to counterparties	Fixed	(3.7610)
Net rate (Paid)/received for swap		(2.0311)
Average variable rate on 2008A bonds, year end		(1.5500)
Plus remarketing and liquidity fees on 2008A bonds		(0.4450)
Effective rate of 2008A bonds		(4.0261)

Fair value. The swap had a fair value of $10,300,000 on June 30, 2008. This value was calculated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These net payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit risk. As of June 30, 2008, the City was exposed to credit risk because the swaps had a negative fair value. However, should interest rates increase and the fair value of swap become positive, the City would be exposed to credit risk on the swap in the amount of its fair value. The City's swap policy generally requires that swap counterparties be rated double-A or better. As of June 30, 2008, RBC met this requirement with ratings of Aaa/AA-/AA. Also, under the agreements, if a counterparty's credit rating falls below double-A, collateral must be posted in varying amounts depending on the credit rating. No collateral has been required to date.

Basis risk. The City will be exposed to basis risk on the swap because the variable payment received is based on an index that is not tax-exempt. Should the relationship between LIBOR and SIFMA move to convergence (because of reductions in tax rates, for example), the expected cost savings may not be realized. At June 30, 2008, the interest rate in effect for the underlying variable rate demand bonds was 1.55%, while the rate in effect for the swap receipts was 1.73%.

Termination risk. The City may terminate for any reason. RBC may terminate a swap if the City fails to perform under the terms of the contract. The City's on-going payment obligations under the swap (and, to a limited extent, its termination payment obligations) are insured, and RBC cannot terminate so long as the insurer does not fail to perform. If a swap should be terminated, the associated variable-rate bonds would no longer carry synthetic fixed interest rates. Also, if at the time of the termination the swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt. As of June 30, 2008, debt service requirements for the swap agreements are reported in Note 8D, assuming current interest rates remain the same. As rates vary, variable rate bond interest payments and net swap payments will vary. Expected debt service payments on the associated Combined Utility System 2004C bonds are included with other Combined Utility System Bonds on Note 8D.

16. Combined Utility System Constant Maturity Swap

Combined Utility System Constant Maturity Swap. In November 2006 the City executed a constant maturity swap with Goldman Sachs Capital Markets, Inc. ("Goldman") on a forward basis. The swap was priced competitively.

Objective. This swap essentially trades receipts on the forward rate lock with RBC for receipts based on a longer index. The objective of the swap is to minimize interest expense associated with the 2004C-2 Bonds. The City's goal is that over time, as the yield curve returns to its normal ascending slope, receipts from this swap will exceed the payments made on the swap.

Terms. The notional amount of the swap is $249.1 million with the underlying bonds being part of the 2004C Bonds converted to a tax-exempt status in December 2007. The swap agreement contains scheduled reductions to the outstanding notional amount that follows anticipated payments of principal of the 2004C Bonds during the years 2028 to 2034.

Under terms of the swap, the City will pay a variable rate of 70% of 1 Month LIBOR (equal to its receipts on the RBC forward rate lock swap) and receive a variable rate equal to 64.29% of Ten Year US Dollar LIBOR. The agreement became effective December 3, 2007 and has a termination date of May 15, 2034.

Receipts and Payments. Through June 30, 2008, revenue earned on the constant maturity swap was $580,000.

Fair value. As a result of changes in the swap yield curve, the estimated fair value of the swap at June 30, 2008 was positive $3,600,000. The amount was calculated using the zero-coupon method.

Credit risk. The City's swap policy generally requires that swap counterparties be rated double-A or better by at least one nationally recognized rating agency. As of this date, Goldman met this requirement with ratings of Aa3/AA-/AA-. Also, under the agreement, if Goldman's credit rating falls below double-A, collateral must be posted in varying amounts depending on the credit rating and swap fair value. No collateral has been required to date.

Basis risk. The City will be exposed to basis risk on the swap because the variable payment received is based on a longer-term index than the rate paid by the City on the bonds. In the future, if long term 10- year LIBOR rates equal or fall below the One-Month LIBOR index, the expected cost savings may not be realized, resulting in a higher synthetic rate.

Termination risk. The City may terminate for any reason. Goldman may terminate a swap if the City fails to perform under the terms of the contract. If the swap is terminated, the City would revert to receipts on the One-Month LIBOR index on its 2004C Bonds. Also, if the swap has a negative fair value at termination, the City would be liable to Goldman for a payment equal to the swap's fair value.

Swap payments and associated debt. As of June 30, 2008, debt service requirements for the swap agreements are reported assuming current interest rates remain the same. As rates vary, variable rate bond interest payments and net swap payments will vary. Expected debt service payments on the associated Combined Utility System 2004C bonds are included with other Combined Utility System Bonds on Note 8D.

17. Water and Sewer System Junior Lien Revenue Bonds

These bonds are paid solely from a lien on the net water and sewer system revenues, which must total 110% of the current debt service requirements on the junior lien bonds. As part of the restructuring to the new Combined Utility System, the City refunded a substantial portion of the outstanding junior lien bonds on June 10, 2004 and reissued bonds as Combined Utility System bonds. Debt service payments on remaining Water and Sewer Junior Lien Revenue Bonds will be made after payment of operating expenses and prior to any debt service payments on the Combined Utility System bonds. The final maturity date for the remaining junior lien bonds is December 1, 2028.

18. Coastal Water Authority ("CWA")

The contract payable relating to CWA represents the outstanding principal balance of $101,785,000 at June 30, 2008 of City of Houston Water Conveyance System Contract Certificates of Participation, Series 1993, representing contract payments owed by the City to pay debt service on bonds issued by CWA, plus $82,860,000 of CWA Revenue Refunding Bonds, Series 1999 and Series 2004, issued by CWA, a governmental agency of the State of Texas, to finance the construction of a water conveyance system.

Pursuant to a series of exchange agreements with CWA, the City issued the Certificates and endorsed the bonds and is unconditionally obligated to pay from the gross operating revenues of the City's water and sewer system all debt service payments on these Certificates and Bonds, as well as amounts necessary to restore deficiencies in funds required to be accumulated under the CWA bond resolutions. The bonds mature on December 15, 2034.

19. Trinity River Authority ("TRA")

Pursuant to a contract with TRA, a governmental agency of the State of Texas, the City had endorsed bonds associated solely with the project to finance construction of a dam and reservoir on the Trinity River near Livingston, Texas and was unconditionally obligated to pay from the gross operating revenues of the City's water system maintenance and operating expense of the reservoir and amounts necessary to restore any deficiencies in funds required to be accumulated under the TRA bond resolutions.

As consideration for the above obligation, the City receives a perpetual 70% beneficial interest in these reservoir facilities and the use of 70% of the reservoir water. As consideration for the remaining 30% interest in the reservoir facilities and water, TRA is obligated to allow the City credits for water usage. Consequently, the cost of the City's obligation of TRA was not reflected in the City's accounts as a receivable or as a reduction of the cost of the City's 70% interest in the facilities. The bonds matured on April 15, 2008.

20. Houston Area Water Corporation ("HAWC")

The HAWC Series 2002 Bonds were special obligations of the City that were issued to provide financing for the acquisition of rights-of-way and real property interests, and the design, construction and equipping of the Northeast Water Purification Plant and a water conveyance system. The HAWC Bonds were refunded with proceeds of the Combined Utility System Revenue Refunding bonds, Series 2007B, issued on July 17, 2007.

21. Other Contracts

On June 20, 1967 the City, TRA, and Chambers-Liberty Counties Navigation District contracted with the United States of America to have the U.S. Army Corps of Engineers build a salinity control barrier and recreation facilities at Wallisville Lake. Because of legal actions, construction was blocked for a long period, and the project was not completed until April 2003. The City's share of the project cost was $10,580,707, which will be paid to the U.S. government over 50 years at 3.222% interest with final payment due January 1, 2053. Payments will be made only after funding all maintenance and operation costs and debt service payments for the water and sewer system, including required reserves.

In April 2000 the City, Brazos River Authority ("BRA"), and the Texas Water Development Board ("TWDB") entered into an agreement to develop the Allen's Creek water supply reservoir in Fort Bend County as a regional water supply. TWDB committed to provide up to $20,000,000, or up to 50% of funding, to provide for construction of the project. The City and BRA agreed to purchase TWDB's ownership share in future years. In 2004 the TWDB paid $14 million for site acquisition for the project. The City will purchase TWDB's share. Interest payments on the lease-purchase began in 2005 at an average rate of 5.85%. Interest costs over the first eight years will be partially deferred to later years. Principal payments will begin in 2022, and the final principal payment will be made in 2036.

22. Deferred Electrical Charges

On February 27, 2006 the City entered into an agreement with its electricity provider, the Texas General Land Office, that changed the City's pricing formula to allow certain electricity expenses to be deferred. The City opted to defer $15,000,000 at that time. At June 30, 2008 the remaining deferred charges totaled $5,391,000 distributed over the governmental and the enterprise funds as reported in Note 8A. The deferred amounts will be paid in monthly increments according to formula adjustments through June 2009, or the City may pay the remaining balance at any time. The payments will be paid from the operating funds that originally incurred the charges.

D. Schedule for Debt Service Requirements to Maturity (in thousands):

1. General Long-Term Tax Obligation Debt (adjusted for Capital Appreciation and Deferred Interest Bonds reclassification of principal & interest) (in thousands):

Year Ending June 30	Public Improvement Bonds		General Obligation Swap Agreements	Pension Obligation Bonds	
	Principal	Interest	Payment Receipts	Principal	Interest
2009	$ 133,880	$ 91,013	$ (1,530)	$ 35,050	$ 32,919
2010	133,785	84,242	(1,530)	-	31,716
2011	131,765	77,516	(1,530)	547	31,716
2012	125,640	70,793	(1,530)	1,164	31,645
2013	118,665	64,500	(1,530)	-	-
2014-2018	565,055	234,125	(7,416)	18,779	154,973
2019-2023	391,260	107,902	(2,984)	24,904	145,127
2024-2028	142,725	27,974	(154)	2,332	138,493
2029-2033	30,670	11,149	-	56,047	135,182
2034-2038	24,705	2,798	-	333,381	61,070
Total	$ 1,798,150	$ 772,012	$ (18,204)	$ 472,204	$ 762,841

Year Ending June 30	General Obligation Commercial Paper		Tax and Revenue Certificates of Obligation		Deferred Electricty Note	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ -	$ 11,346	$ 5,938	$ 4,343	$ 1,515	$ 80
2010	443,950	10,579	6,440	3,684	-	-
2011	159,000	2,623	6,523	6,161	-	-
2012	23,000	154	6,250	3,269	-	-
2013	-	-	11,095	2,984	-	-
2014-2018	-	-	15,835	10,925	-	-
2019-2023	-	-	19,065	6,684	-	-
2024-2028	-	-	15,375	1,969	-	-
2029-2033	-	-	-	-	-	-
2034-2038	-	-	-	-	-	-
Total	$ 625,950	$ 24,702	$ 86,521	$ 40,019	$ 1,515	$ 80

Year Ending June 30	Total Future Requirements			
	Principal	Interest	Swaps (Receipts)	Total Future Requirements
2009	$ 176,383	$ 139,701	$ (1,530)	$ 314,554
2010	584,175	130,221	(1,530)	712,866
2011	297,835	118,016	(1,530)	414,321
2012	156,054	105,861	(1,530)	260,385
2013	129,760	67,484	(1,530)	195,714
2014-2018	599,669	400,023	(7,416)	992,276
2019-2023	435,229	259,713	(2,984)	691,958
2024-2028	160,432	168,436	(154)	328,714
2029-2033	86,717	146,331	-	233,048
2034-2038	358,086	63,868	-	421,954
Total	$ 2,984,340	$ 1,599,654	$ (18,204)	$ 4,565,790

2. HUD Section 108 Loans (in thousands):

Year Ending June 30	Section 108 Loans		
	Principal	Interest	Total Future Requirements
2009	$ 1,745	$ 968	$ 2,713
2010	1,825	866	2,691
2011	1,700	760	2,460
2012	1,389	659	2,048
2013	1,077	574	1,651
2014-2018	4,019	1,906	5,925
2019-2023	3,305	499	3,804
Total	$ 15,060	$ 6,232	$ 21,292

3. Business-Type Funds (adjusted for Capital Appreciation and Deferred Interest Bonds reclassification of principal & interest) (in thousands):

Year Ending June 30	Airport System Revenue Bonds		Airport System Commercial Paper		Airport System Inferior Lien Contract	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ 43,050	$ 104,096	$ -	$ 1,588	$ 3,880	$ 2,602
2010	40,840	101,814	-	1,588	4,085	2,388
2011	51,885	99,600	83,000	818	4,305	2,163
2012	52,285	96,863	-	-	4,535	1,925
2013	51,240	94,124	-	-	4,780	1,675
2014-2018	316,585	425,163	-	-	28,115	4,031
2019-2023	406,125	333,274	-	-	-	-
2024-2028	523,495	217,302	-	-	-	-
2029-2033	640,800	81,626	-	-	-	-
2034-2038	-	-	-	-	-	-
Total	$ 2,126,305	$ 1,553,862	$ 83,000	$ 3,994	$ 49,700	$ 14,784

Year Ending June 30	Airport System Pension Obligations		Airport System Deferred Electricity Contract	
	Principal	Interest	Principal	Interest
2009	$ -	$ 3,064	$ 1,011	$ 53
2010	-	3,064	-	-
2011	-	3,064	-	-
2012	-	3,064	-	-
2013	-	3,065	-	-
2014-2018	-	15,323	-	-
2019-2023	-	15,323	-	-
2024-2028	-	15,323	-	-
2029-2033	1,627	15,159	-	-
2034-2038	35,179	3,491	-	-
Total	$ 36,806	$ 79,940	$ 1,011	$ 53

Airport System
Total Future Requirements

Principal	Interest	Total Future Requirements
$ 47,941	$ 111,403	$ 159,344
44,925	108,854	153,779
139,190	105,645	244,835
56,820	101,852	158,672
56,020	98,864	154,884
344,700	444,517	789,217
406,125	348,597	754,722
523,495	232,625	756,120
642,427	96,785	739,212
35,179	3,491	38,670
$ 2,296,822	$ 1,652,633	$ 3,949,455

Year Ending June 30	Convention and Entertainment Facilities Revenue Bonds		Convention and Entertainment Facilities Commercial Paper		Convention and Entertainment Pension Obligations	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ 18,620	$ 20,114	$ -	$ 848	$ -	$ 291
2010	21,230	19,052	-	848	-	291
2011	23,260	17,938	43,800	451	-	291
2012	24,835	16,543	-	-	-	291
2013	27,830	15,103	-	-	-	291
2014-2018	116,385	78,444	-	-	-	1,452
2019-2023	94,642	101,295	-	-	-	1,452
2024-2028	98,384	121,335	-	-	-	1,452
2029-2033	112,483	131,108	-	-	153	1,437
2034-2038	24,065	25,808	-	-	3,336	331
Total	$ 561,734	$ 546,740	$ 43,800	$ 2,147	$ 3,489	$ 7,579

Year Ending June 30	Convention and Entertainment Deferred Electricity Contract		Convention and Entertainment Total Future Requirements		
	Principal	Interest	Principal	Interest	Total Future Requirements
2009	$ 255	$ 13	$ 18,875	$ 21,266	$ 40,141
2010	-	-	21,230	20,191	41,421
2011	-	-	67,060	18,680	85,740
2012	-	-	24,835	16,834	41,669
2013	-	-	27,830	15,394	43,224
2014-2018	-	-	116,385	79,896	196,281
2019-2023	-	-	94,642	102,747	197,389
2024-2028	-	-	98,384	122,787	221,171
2029-2033	-	-	112,636	132,545	245,181
2034-2038	-	-	27,401	26,139	53,540
Total	$ 255	$ 13	$ 609,278	$ 556,479	$ 1,165,757

Year Ending June 30	Combined Utility System Revenue Bonds		Combined Utility System Swap Agreements	Combined Utility System Commercial Paper	
	Principal	Interest	Net Swap Payment	Principal	Interest
2009	$ 16,400	$ 174,827	$ 14,549	$ -	$ 3,105
2010	41,665	174,649	14,549	-	3,105
2011	43,100	172,560	14,549	-	3,105
2012	28,320	170,249	14,549	-	3,105
2013	40,940	168,449	14,549	-	3,105
2014-2018	434,675	792,587	72,744	156,500	7,639
2019-2023	630,390	680,826	72,744	-	-
2024-2028	979,940	473,758	72,744	-	-
2029-2033	1,316,915	243,666	56,405	-	-
2034-2038	613,060	45,009	4,527	-	-
Total	$ 4,145,405	$ 3,096,580	$ 351,909	$ 156,500	$ 23,164

Year Ending June 30	Water and Sewer Jr. Lien Revenue Bonds		Combined Utility System Pension Obligations	
	Principal	Interest	Principal	Interest
2009	$ 21,283	$ 52,070	$ -	$ 4,566
2010	26,022	56,246	-	4,566
2011	30,754	56,415	-	4,565
2012	42,045	65,812	-	4,566
2013	41,523	65,665	-	4,565
2014-2018	307,990	81,432	-	22,828
2019-2023	236,432	71,586	-	22,828
2024-2028	55,721	91,903	-	22,828
2029-2033	8,430	35,664	2,743	22,552
2034-2038	-	-	52,239	5,185
Total	$ 770,200	$ 576,793	$ 54,982	$ 119,049

Year Ending June 30	Combined Utility System Deferred Electricity Contract		Combined Utility System Total Future Requirements			
	Principal	Interest	Principal	Interest	Net Swap Payment	Total Future Requirements
2009	$ 2,610	$ 137	$ 40,293	$ 234,705	$ 14,549	$ 289,547
2010	-	-	67,687	238,566	14,549	320,802
2011	-	-	73,854	236,645	14,549	325,048
2012	-	-	70,365	243,732	14,549	328,646
2013	-	-	82,463	241,784	14,549	338,796
2014-2018	-	-	899,165	904,486	72,744	1,876,395
2019-2023	-	-	866,822	775,240	72,744	1,714,806
2024-2028	-	-	1,035,661	588,489	72,744	1,696,894
2029-2033	-	-	1,328,088	301,882	56,405	1,686,375
2034-2038	-	-	665,299	50,194	4,527	720,020
Total	$ 2,610	$ 137	$ 5,129,697	$ 3,815,723	$ 351,909	$ 9,297,329

4. Long-Term Contracts-Combined Utility System (in thousands):

Year Ending June 30	Coastal Water Authority Future Requirements		
	Principal	Interest	Total
2009	$ 18,155	$ 9,948	$ 28,103
2010	14,825	8,991	23,816
2011	13,250	8,117	21,367
2012	13,340	7,246	20,586
2013	13,440	6,394	19,834
2014-2018	48,950	20,675	69,625
2019-2023	20,730	12,928	33,658
2024-2028	20,870	7,288	28,158
2029-2033	14,345	3,371	17,716
2034-2039	6,740	324	7,064
Total	$ 184,645	$ 85,282	$ 269,927

Year Ending June 30	Water & Sewer System Contracts				Other Contracts Total Future Requirements		
	U.S. Army Corps of Engineers		Texas Water Development Board				
	Principal	Interest	Principal	Interest	Principal	Interest	Total
2009	$ 100	$ 316	$ -	$ 327	$ 100	$ 643	$ 743
2010	103	312	-	450	103	762	865
2011	106	309	-	573	106	882	988
2012	110	306	-	696	110	1,002	1,112
2013	113	302	-	819	113	1,121	1,234
2014-2018	623	1,454	-	6,127	623	7,581	8,204
2019-2023	730	1,347	610	1,497	1,340	2,844	4,184
2024-2028	855	1,221	3,620	3,520	4,475	4,741	9,216
2029-2033	1,002	1,074	4,805	2,335	5,807	3,409	9,216
2034-2038	1,175	902	4,965	750	6,140	1,652	7,792
2039-2043	1,376	700	-	-	1,376	700	2,076
2044-2048	1,613	464	-	-	1,613	464	2,077
2049-2053	1,890	187	-	-	1,890	187	2,077
Total	$ 9,796	$ 8,894	$ 14,000	$ 17,094	$ 23,796	$ 25,988	$ 49,784

E. Debt Issuances and Refundings

Throughout its history, the City has issued refunding bonds from time to time when there has been an operational or economic gain for the City. These refundings have been structured as legal defeasances of the old debt as ruled by the Texas Attorney General, and such debt, including the debt balances refunded during fiscal 2007 described below, has been removed from the City's books.

Combined Utility System Revenue Refunding Bonds

On July 10, 2007 the City closed the sale of $392,230,000 of Combined Utility System Revenue Refunding Bonds Series 2007A. The bonds were issued at rates of 4.5% and 5.0% with an average yield of 4.83%. The bonds are due in varying amounts from 2012 to final maturity on November 15, 2036. The proceeds were used to currently refund $400,200,000 of outstanding Combined Utility System Commercial Paper Notes at fixed rates rather than to achieve present value savings

On July 17, 2007 the City closed the sale of $123,555,000 of Combined Utility System Revenue Refunding Bonds Series 2007B. The bonds were issued at a rate of 5.0% with an average yield of 4.69%. The bonds are due in varying amounts from 2012 to final maturity on November 15, 2031. The proceeds were used to advance refund all outstanding Houston Area Water Corporation Bonds, Series 2002, and to pay costs of issuance. The transaction resulted in increased cash payments of $1,440,000, but the net present value savings of the transaction was $3,542,000 or 2.82%.

On April 21, 2008 the City closed the sale of $45,050,000 of Combined Utility System Revenue and Refunding Bonds Series 2008B and $52,650,000 of Combined Utility System Revenue Refunding Bonds Series 2008C. The bonds were sold to the Texas Water Development Board ("TWDB") in a private placement. The bonds were issued at rates ranging from 0.35% to 4.05% with an average yield of 3.29%. The bonds are due in varying amounts from 2008 through 2037. Proceeds were used to currently refund $62 million of Combined Utility System Commercial Paper at fixed rates, to fund future projects approved by TWDB, and to pay costs of issuance.

Because of problems in the auction rate bond market, on May 8 and May 9, 2008 the City issued $249,075,000 of Combined Utility System Revenue Refunding Bonds, Series 2008A, in a weekly mode as variable rate demand bonds. The proceeds were used to refund $249,075,000, a part of Combined Utility System Revenue Refunding Bonds, Series 2004C, that had been issued as auction rate bonds.

On June 20, 2008 the City closed the sale of $132,010,000 of Combined Utility System Revenue and Refunding Bonds, Series 2008D1. The bonds were issued as adjustable rate bonds with interest rates resetting on a weekly basis. The bonds were issued to refund Combined Utility System Revenue and Refunding Bonds, Series 2004C5, which were issued as auction rate bonds, and to pay cost of issuance. The bonds are due in varying amounts from 2028 to final maturity on May 15, 2034.

On June 25, 2008 the City closed the sale of $73,255,000 of Combined Utility System Revenue and Refunding Bonds, Series 2008D2 and 2008D3. The bonds were issued as adjustable rate bonds with interest rates resetting on a weekly basis. The bonds were issued to refund Combined Utility System Revenue and Refunding Bonds, Series 2004C3 and 2004C4, which were issued as auction rate bonds, and to pay cost of issuance. The bonds are due in varying amounts from 2028 to final maturity on May 15, 2034.

Combined Utility System First Lien Revenue Refunding Bonds Series 2004 Conversions

During the first week of December 2007 Combined Utility System Revenue Refunding Bonds, Series 2004C2, (the "Series 2004C2 bonds") converted from taxable to tax-exempt status. The Series 2004C2 bonds were originally issued as taxable bonds to advance refund certain obligations (the "Original Bonds") because the original bonds could not be advance refunded at that time on a tax-exempt basis. The Series 2004C2 bonds became eligible for tax-exempt status and were therefore converted between December 3 and December 7, 2007.

Because of problems in the auction bond market, between April 8 and April 14, 2008 the City converted all $653,325,000 of Combined Utility System Revenue Refunding Bonds, Series 2004B, from an auction rate mode to a weekly mode as variable rate demand obligations.

Because of problems in the auction bond market, between May 22 and May 27, 2008 the City converted $274,125,000 of Combined Utility System Revenue Refunding Bonds, Series 2004C from an auction rate mode to a special term rate mode. The bonds were converted at a yield of 3.9%; the bonds will be remarketed at the prevailing market rate on May 15, 2011.

Airport System Subordinate Lien Revenue Refunding Bonds

On September 12, 2007 the City issued $298,670,000 of Airport System Subordinate Lien Revenue Refundings Bonds Series 2007B (Non-AMT). The bonds were issued at rates of 4.0 to 5.0% with an average yield of 4.77%. The bonds are due in varying amounts from 2008 to final maturity on July 1, 2027. The proceeds were used to currently refund $30,960,000 of Airport System Subordinate Lien Revenue Refunding Bonds Series 1997 and $43,000,000 of Airport System Senior Lien Commercial Paper Notes, to advance refund $224,725,000 of Airport System Subordinate Lien Revenue Bonds Series 2000B, and to pay costs of issuance. The commercial paper was refunded to lock in fixed rates rather than to achieve present value savings. Cash savings on the current refunding will be $2,579,000, and the net present value savings are $1,507,000 or 4.87%. Cash savings on the advance refunding will be $30,493,000, and the net present value savings are $14,982,000 or 6.67%.

Taxable Pension Deferred Interest Certificate

On October 1, 2007 the City elected to defer $16,498,500 in interest payments on its $300,000,000 Collateralized Pension Obligation Note, and to allocate such deferred interest to the Uncollateralized Deferred Interest Certificate ("the Certificate"), as allowed by the ordinance authorizing issuance of the Note. (The City made a partial payment of $9,001,500 on the $25,500,000 interest incurred on the Note.) The Certificate will bear interest at the greater of a) 8.5%, or b) the yield on April 1 of each year for the Treasury obligation maturing closest to December 1, 2033, plus a predefined rate adjustment. Under the authorizing ordinance, the City is allowed to defer up to $150,000,000 in interest on the Note. Under the authorizing ordinance, the City must pay down the Certificate by December 1, 2033.

HUD Loan Defeasance

On November 1, 2007 the City advance refunded $3,160,000 of its HUD Section 108 loan with proceeds received from an early payment by Crowne Plaza.

Public Improvement Refunding Bonds

On December 6, 2007 the City issued $219,660,000 of Public Improvement Refunding Bonds, Series 2007A, at rates ranging from 4.0 to 5.0%. Average yield was 4.46%. The bonds are due in varying amounts from March 2009 to March 2037. Proceeds were used to advance refund $47,870,000 of Public Improvement Refunding Bonds Series 1997A; to currently refund $177,800,000 of General Obligation Commercial Paper Series D, E and F; and to pay costs of issuance. Cash savings on the advanced refunding will be $2,212,000, and the net present value savings of the transaction was $1,886,000 or 3.94%. The commercial paper was refunded to lock in fixed rates rather than to achieve present value savings.

General Obligation Certificates of Obligation

On December 6, 2007 the City issued $8,575,000 Certificates of Obligation, Series 2007B, with a 5.0% interest rate. Average yield was 3.79%. Proceeds will be used to fund the demolition of dangerous buildings within the City and to pay costs of issuance.

Taxable Pension Obligation Bonds

On February 15, 2008 the City issued a $35,050,000 Taxable Pension Obligation Note at a 3.35% rate. The Note will mature on February 18, 2009. Proceeds were used to fund $35,000,000 of the Houston Police Officers Pension System Unfunded Actuarial Accrued Liability and to pay costs of issuance.

F. Bond Compliance Requirements

The revenue bond ordinances require that during the period in which the bonds are outstanding the City must create and maintain certain accounts or funds to receive the proceeds from the sale of the revenue bonds and to account for the revenues (as defined), which are pledged for payment of the bonds. The assets can be used only in accordance with the terms of the bond ordinance and for the specific purpose(s) designated therein. The City is generally required to make a monthly transfer to debt service funds equal to one-sixth of the next interest payment and one-twelfth of the next principal payment. Certain bond ordinances have additional requirements for the establishment of rates and the accumulation of principal and interest repayment amounts from surplus operating funds. Generally, the bonds may be redeemed prior to their maturities in accordance with the bond ordinances and at various premiums equal to or less than 2%. During fiscal year 2008 the City has complied with the requirements of all revenue bond ordinances and related bond restrictions.

G. Voter Authorized Obligations

On November 4, 2001, voters of the City authorized the issuance of $776,000,000 of Public Improvement Bonds. Since June 2002 City Council has authorized issuance of $500,000,000 as General Obligation Commercial Paper Series D and $276,000,000 as General Obligation Commercial Paper Series G.

On November 7, 2006, voters of the City authorized the issuance of $625,000,000 in additional Public Improvement Bonds.

In addition, the City is authorized by the City Charter to issue $100,000 annually in general improvement bonds without voter approval.

H. Legal Debt Margin

At June 30, 2008 the City's legal debt limit was 10% of assessed property valuation totaling $173,824,873. The City's legal debt margin was $14,304,375.

Note 9: Leases

Operating Leases

A. City as Lessee

The City has obtained office space, data processing and other equipment through long-term operating leases. The total cost for such leases was $9,409,239 for the year ended June 30, 2008. The cost is $5,037,494 for the General funds, $1,516,202 for the Grant funds, $1,435,209 for the Non-Major Governmental funds, $808,252 for the Combined Utility System funds, $312,576 for the Airport System funds, $217,000 for the Capital Projects funds, $42,945 for the Convention and Entertainment Facilities funds and $39,561 for the Internal Service funds.

The future minimum payments under these agreements are as follows (in thousands):

Year ended June 30	Operating Lease Payments
2009	$ 5,257
2010	3,851
2011	3,403
2012	3,045
2013	2,289
2014-2018	992
Total	$ 18,837

B. City as Lessor

The Convention and Entertainment Facilities department is the lessor of one (1) land lease, Toyota Center Land Lease, with an asset cost of $20,000,000; five (5) building leases of which all are substantially leased with asset costs of $117,127,453 and carrying costs of $72,838,575. Accumulated depreciation on these assets is $44,288,877. These buildings located in the Theater District are; Houston Center for the Arts, Wortham Theater, Jones Hall Theater, Talento Bilingue and the Downtown Aquarium. All buildings are used for performance and entertainment purposes.

The Airport System is the lessor of approximately 10 percent of its land and substantially all of its buildings and improvements. These lease agreements are non-cancelable operating leases with fixed minimum rentals and non-cancelable operating use and lease agreements with annually adjusted rates. Rental income is earned from leasing various parcels of land with asset costs of $20,743,916 to airlines, fixed base operators and various corporations for hangars, aircraft maintenance facilities, flight kitchens and cargo buildings; to auto rental companies for their service facilities and storage lots; and to a variety of other entities for buildings and other permanent improvements. Airlines and airport concessionaires lease various sections of City owned airport buildings and improvements for ticket counters, passenger hold rooms, baggage carousels, restaurants, retail stores and other facilities. Leased buildings, improvements and equipment have asset costs of $3,741,651,798 and carrying costs of $2,413,570,166. Accumulated depreciation on all these assets is $1,328,081,632. Minimum guaranteed income on such non-cancelable operating leases is as follows (in thousands):

Year Ended June 30	Operating Leases Minimum Rental Income
2009	$ 38,569
2010	30,324
2011	28,572
2012	27,914
2013	24,010
2014-2018	112,902
2019-2023	103,449
2024-2028	86,168
2029-2033	23,782
2034-2038	15,017
2039-2043	11,086
2044-2048	395
2049-2053	250
Total	$ 502,438

The contingent income associated with these non-cancelable operating leases was approximately $12,088,511 in fiscal year 2008. In addition, income is earned from certain non-cancelable operating use and lease agreements for landing fees and terminal building rentals. Such income is adjusted annually based on a compensatory formula to recover certain operating and capital costs of the related facilities. Such income for fiscal year 2008 was approximately $288,645,392.

Note 10: Pension Plans

A. Plan Descriptions

The City has three single employer defined benefit pension plans (Firefighters' Relief and Retirement Fund, Municipal Employees' Pension System, and the Police Officers' Pension System), which cover substantially all of its employees. These pension plans were established under the authority of Texas statutes (Vernon's Texas Civil Statutes, Articles 6243.e2 (1), 6243g, 6243g-4, respectively), which establish the various benefit provisions. All plans provide for service-connected disability and death benefits to survivors, with no age or service eligibility requirements. Employer and employee obligations to contribute, as well as employee contribution rates, are included in the statutes, and for the Municipal Employees' Pension System and the Houston Police Officers' Pension System, some requirements are delineated in new (September '04) meet and confer agreements. Additionally, these laws provide that employer funding be based on periodic actuarial valuations, statutorily approved amounts or, in the cases of the Municipal Employees' Pension System and the Police Officers' Pension System, amounts agreed to in meet and confer agreements. All pension plans provide service, disability, death, and vesting benefits. In addition, each pension plan recognizes participant and employer contributions as revenues in the period in which they are due pursuant to formal commitments and recognizes benefits and refunds when they are due and payable in accordance with the terms of the pension statutes. The specific summary plan description for each Plan is available at the plan offices.

On November 10, 2004 the City issued a $300,000,000 collateralized note ("The Collateralized Note") to HMEPS as part of the meet and confer agreement with HMEPS to fund part of the unfunded accrued actuarial liability of its pension plan. The collateralized note bears interest at 8.5% per year unless the rate of adjustment formula based on U.S. Treasury securities maturing in 2003, calls for a higher interest rate. The promissory note from the Houston Hotel Corporation to the City, as well as the related Deed of trust, is pledged as collateral on the collateralized notes. Interest on the collateralized notes may be paid or deferred, at the City's option, up to a maximum of $150,000,000 plus 75% of the amount by which the appraisal value of the hotel exceeds $300,000,000. If the interest is deferred, the City will issue uncollateralized deferred interest certificates that may be converted to assignable certificates at the request of HMEPS up to $150 million, or collateralized deferred interest certificates up to the limit based on the appraisal value of the hotel. The Collateralized Note constitutes a general obligation of the City with an ad valorem tax pledge, but the City may look to other revenue sources available to pay the debt, including the collateral and its proceeds as well as interest deferrals.

B. Actuarially Determined Contribution Requirements and Contributions Made

Historically, the City's funding policies have provided for actuarially determined periodic contributions at rates such that, over time, they will remain level as a percent of payroll, except for the police officers pension system, which has had a statutorily limited level of employer contributions. The contribution rate for normal cost is determined using the entry age normal actuarial cost method. The firefighters' and municipal pension plans use the level percentage of payroll method to amortize the unfunded actuarially accrued liability (or surplus) over 30 years from July 1, 2004 and the police pension uses the level percentage of payroll method to amortize the unfunded actuarially accrued liability over 30 years (constant). (See "Subsequent Events" note on page 114 and 115 for further pension information related to the municipal and police pension funds.)

The reported contributions to the pension funds for the year ended June 30, 2008, were different from the actuarially determined requirements based on July 1, 2007 actuarial valuation for Municipal, Fire, and Police. Contributions are as follows:

Percentage of Payroll	Firefighters	Municipal	Police
City of Houston normal cost	21.5%	5.8%	16.0%
Amortization of unfunded actuarial accrued liability (surplus)	7.9%	13.6%	16.1%
Required employer contribution rate	29.4%	19.4%	32.1%
Employer contribution made	23.9%	15.7%	16.3%
Employee contribution made	9.0%	5.0%	9.0%
Contribution Amounts (in thousands)			
Net contribution required	$ 86,742	$ 114,090	$ 155,186
Total City contribution	53,981	75,000	63,000
Total employee contribution	20,431	21,176	31,003
Total contribution	$ 74,412	$ 96,176	$ 94,003

C. Annual Pension Cost and Net Pension (Obligation) Asset

The annual pension cost associated with the City's three pension funds for the current year is as follows (in thousands):

	Houston Firefighters' Pension	Houston Municipal Employees' Pension	Houston Police Officers' Pension
Annual required contribution	$ 66,311	$ 92,914	$ 124,183
Interest on net pension obligation	2,267	22,416	21,424
Adjustment to annual required contribution	(1,879)	(18,585)	(16,084)
Annual pension cost	66,699	96,745	129,523
Contribution made	53,981	75,000	63,000
Change in net pension obligation	(12,718)	(21,745)	(66,523)
Net pension obligation beginning	(26,666)	(263,718)	(252,044)
Net pension obligation end of year	$ (39,384)	$ (285,463)	$ (318,567)

D. Schedule of Funding Progress (in millions)

	Houston Firefighters' Pension	Houston Municipal Employees' Pension	Houston Police Officers' Pension
Actuarial Valuation Date	July 1, 2007	July 1, 2007	July 1, 2007
Actuarial Value of Plan Assets (a)	$2,633.6	$2,193.7	$3,004.9
Actuarial Accrued Liability (AAL) Entry Age (b)	$2,892.3	$3,128.7	$3,857.7
Unfunded AAL (Surplus UAAL) (b - a)	$258.7	$935.0	$852.8
Funded Ratio (a/b)	91%	70%	78%
Projected Annual Covered Payroll (c)	$232.4	$448.9	$336.0
UAAL as Percentage of Covered Payroll ((b - a)/c)	111%	208%	254%

E. Houston Firefighters' Pension System

Schedule of Employer Contributions (in millions)

Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Asset (Obligation)	Annual Required Contribution as a % of Base Pay
2005	$52.2	62.5%	$29.7	31.1%
2006	$90.8	61.9%	($4.8)	31.1%
2007	$74.7	70.8%	($26.7)	33.5%
2008	$66.7	80.9%	($39.4)	29.4%

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as to the actuarial valuation used for purposes of the financial statements is as follows:

Valuation date	July 1, 2007
Actuarial cost method	Entry age Normal Cost
Amortization method	Level percent of payroll over an open period of 30 years
Remaining amortization period	Rolling 30 year
Asset valuation method	5 year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%, net of expenses
Inflation rate	3.0%
Payroll growth rate	3.0%
Annual increase attributable to seniority/merit	3.0% to 7%
Cost of living adjustment	3% annually

F. Houston Municipal Pension System Information

Schedule of Employer Contributions (in millions)

Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Obligation	Annual Required Contribution as a % of Base Pay
2005	$129.4	51.1%	$231.1	29.4%
2006	$62.2	111.0%	$224.3	24.1%
2007	$111.4	64.6%	$263.7	24.1%
2008	$96.7	77.5%	$285.5	19.5%

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as to the actuarial valuation used for purposes of the financial statements is as follows:

Valuation date	July 1, 2007
Actuarial cost method	Entry Age Normal cost
Amortization method	Level percentage of payroll over an open period of 30 years
Remaining amortization period	Rolling 30 year period
Asset valuation method	5 year smoothed market
Actuarial assumptions: investment rate of return	8.5%, net of expenses
Payroll growth factor	3.0%
Projected individual salary increases	Graded rates based on years of service
General inflation rate	3.0%

G. Houston Police Officer's Pension System Information

Schedule of Employer Contributions (in millions)

Year Ended June 30	Annual Pension Cost	Percentage Contributed	Net Pension Obligation	Annual Required Contribution as a % of Base Pay
2005	$105.9	34.6%	$125.9	31.2%
2006	$106.7	49.7%	$179.4	31.2%
2007	$130.6	44.4%	$252.0	34.0%
2008	$129.5	48.6%	$318.6	32.1%

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as to the actuarial valuation used for purposes of the financial statements is as follows:

Valuation date	July 1, 2007
Actuarial cost method	Entry Age Normal Cost
Amortization method	Level percent of payroll Amortized over a constant open period of 30 years
Remaining amortization period	30 years
Asset valuation method	5 year smoothed market
Actuarial assumptions: Investment rate of return	8.5%, with a maximum of 5-year average of 7.0%
Payroll growth rate, attributable entirely to inflation	3.5 %
Annual increase attributable to seniority/merit	0.0% to 9.5%
Annual cost of living adjustment	3.0%
Projected salary increases	Graded rates based on years of service

Note 11: Other Employee Benefits

A. Post-Retirement Health Insurance Benefits

Pursuant to a City Ordinance, the City provides certain health care benefits for retired employees. Substantially all of the City's employees become eligible for these benefits if they reach normal retirement age while working for the City. Contributions are recognized in the year paid. The cost of retiree health care premiums incurred by the City amounted to $54,477,067 for the year ended June 30, 2008. Retiree health care is accounted for in the Health Benefits Fund, an Internal Service Fund. At June 30, 2008, there were 8,653 retirees eligible to receive benefits.

Annual Other Post Employment Benefits (OPEB) Cost and Net OPEB (Obligation) Asset

The annual OPEB cost associated with the City's retiree health care costs for the current year is as follows (in thousands):

	OPEB
Annual required contribution	$ 326,518
Annual OPEB cost	326,518
Contribution made	(54,477)
Increase in net OPEB obligation	272,041
Net OPEB obligation end of year	$ 272,041

Fiscal Year Ended June 30	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2008	$326,518	16.7%	$272,041

Schedule of Funding Progress (in millions)

Year Ended June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b-a)	Funded Ratio	Covered Payroll (C)	UAAL as a % of Covered Payroll ((b-a)/c)
2008	$54.5	$326.5	$272.0	16.7%	$1,090.1	25.0%

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as to the actuarial valuation used for purposes of the financial statements is as follows:

Valuation date	June 30, 2006
Actuarial cost method	Entry age Normal Cost
Amortization method	Level percent of payroll over an open period of 30 years
Remaining amortization period	Rolling 30 year
Discount Rate	4.5%
Annual increase attributable to seniority/merit	3.0% to 12%

B. Health Benefits Internal Service Fund

The City's Health Benefits plan is currently administered by HMO Blue Texas. Employees and retirees are able to choose between an HMO Plan with all benefits covered by third party purchased insurance or a substantially self-insured Preferred Provider Organization Plan (PPO) with specific individual aggregate stop loss features. Specific and aggregate stop loss insurance is provided for the PPO plan of $300,000 and approximately $11,600,000 aggregate bases on enrollment. Premiums paid (employer and subscriber) for current employees to third party administrators totaled $180,912,419 for the year ended June 30, 2008.

The City also provides one times salary of basic life insurance, with a minimum of $15,000, at no cost to the employee. The employee, at no cost to the City, may then obtain additional life insurance up to four times their annual salary. The current cost for active employees for both basic and voluntary life insurance totaled $6,157,628 for the year ended June 30, 2008.

PPO/POS and PPO/OOA Schedule of Changes in Liability (in thousands)

	June 30, 2008	June 30, 2007
Beginning actuarial estimate of claims liability, July 1	$ 937	$ 971
Incurred claims for fiscal year	9,398	9,784
Payments on claims	(9,483)	(10,034)
Actuarial adjustment	59	216
Ending actuarial estimate of claims liability, June 30	$ 911	$ 937

C. Long-Term Disability Plan

The long-term disability plan, accounted for as an internal service fund, is a part of the Income Protection Plan implemented effective September 1, 1985 (renamed the Compensable Sick Leave Plan (CSL) in October, 1996) and is provided at no cost to City employees who are members of CSL. Coverage is effective the later of September 1, 1985 or upon completion of two years of continuous service. When an employee cannot work because of injury or illness, the plan provides income equal to 50% of base pay plus longevity or 70% of base plus longevity when combined with income benefits available from other sources. Plan benefits may be payable after all CSL scheduled sick leave benefits, including frozen sick leave days, have been used, however, not before six months absence from work. The plan is administered by Disability Management Alternatives, Inc., which is reimbursed from the fund for claims as they are paid along with a fee for administrative services. Effective September 1, 2001 the Meet and Confer Agreement established Paid Time Off (PTO) for police classified officers. This replaces their participation in the LTD plan.

	Schedule of Changes in Liability (in thousands)	
	June 30, 2008	June 30, 2007
Beginning actuarial estimate of claims liability, July 1	$ 7,783	$ 7,046
Incurred claims for fiscal year	1,939	1,962
Payments on claims	(805)	(761)
Actuarial adjustment	(657)	(464)
Ending actuarial estimate of claims liability, June 30	$ 8,260	$ 7,783

D. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan), created in accordance with Internal Revenue Code Section 457 as a separately administered trust. The Plan, available to all City employees, permits employees to defer a portion of their salary until future years. The deferred compensation funds are not available until termination, retirement, death or unforeseeable emergency. However, the Plan now offers loans to participant employees. The maximum amount is the lesser of $50,000 or 50% of the total account balance, less any outstanding loans. The minimum loan amount is $1,000. Pursuant to tax law changes, the Plan's assets are no longer subject to the City's general creditors and are not included in these financial statements.

E. Workers' Compensation Self-Insurance Plan

The City has established a Workers' Compensation Self-Insurance Plan, accounted for within the various operating funds. The plan is administered by Cambridge Integrated Services Group, Inc. Funds are wire transferred to Cambridge as needed to pay claims.

At June 30, 2008 the City has an accumulated liability in the amount of $78 million covering estimates for approved but unpaid claims and incurred but not reported claims (calculated on an actuarial basis) recorded in the Statement of Net Assets and Enterprise Funds. The amount of liability is based on an actuarial study.

	Schedule of Changes in Liability (in thousands)	
	June 30, 2008	June 30, 2007
Beginning actuarial estimate of claims liability, July 1	$ 77,724	$ 76,020
Incurred claims for fiscal year	15,366	12,965
Payments on claims	(15,094)	(14,082)
Actuarial adjustment	(10)	2,821
Ending actuarial estimate of claims liability, June 30	$ 77,986	$ 77,724

Note 12: Interfund Transactions

A. Transfers

Transfers during the year ended June 30, 2008, were as follows (in thousands):

	Transferred to:								
Transferred from:	General Fund	Nonmajor Governmental Funds	Debt Service	Capital Projects	Combined Utility System	Convention & Entertainment Facilities	Houston Area Water Corporation	Parking Mngt.	Total Transfers Out
General Fund	$ -	$ 11,123	$ 243,855	$ 92	$ 1,787	$ 2,185	$ -	$ 4,295	$ 263,337
Grants Fund	-	561	-	-	-	-	-		561
Nonmajor Funds	2,483	-	5,884	287	1,020	-	-		9,674
Capital Projects	-	950	61,314	-	-	-	-		62,264
Convention and Entertainment	533	-	-	60	-	-			593
Combined Utility System	-	36,540	25,804	-	-	-	8,823		71,167
Parking Management	6,000	1,107	67				-		7,174
Total transfers in	$ 9,016	$ 50,281	$ 336,924	$ 439	$ 2,807	$ 2,185	$ 8,823	$ 4,295	$ 414,770

Transfers are used to (1) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund and (2) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, (3) use unrestricted revenues in the Combined Utility fund and special revenue fund to finance general fund programs.

The General Fund transferred capital assets valued at $1,787 thousand to the Combined Utility System Fund, $881 to the Convention & Entertainment Facility Fund, and $4,295 to the Parking Management Fund. These transfers are reported as capital contributions by the Combined Utility System, the Convention and Entertainment Facility, and the Parking Management Fund.

B. Transfers to Component Units

Transfers to the Houston Arts Alliance from the Convention and Entertainment Facilities during the year ended June 30, 2008 totaled $11,910,596.

C. Interfund Charges

The General Fund charges the Airport System, Convention and Entertainment Facilities, Combined Utility System, Capital Project, Sign Administration, Auto Dealer's and Cable Television Funds for services provided by the General Fund on behalf of these funds. Such charges totaled $52,345,000 for the year ended June 30, 2008, and are recorded as revenue in the General Fund and as expense, expenditure or capital assets in the funds assessed.

Included in the Fiscal Year 2008 total are charges to the funds for direct and indirect expenses as shown below (in thousands):

	Airport System	Convention & Entertainment Facilities	Combined Utility Sytem	Other Funds	Total
General Services	$ 2,141	$ 443	$ 923	$ 7,443	$ 10,950
Fire Services	13,418	-	-	-	13,418
Police Services	17,744	-	-	-	17,744
Legal	-	-	1,097	16	1,113
Other	189	217	1,295	7,419	9,120
Total	$ 33,492	$ 660	$ 3,315	$ 14,878	$ 52,345

D. Schedule of Amounts Due To and Due From Other Funds

The interfund balances are primarily due to charges for services between funds during the fiscal year and settled shortly after year-end. The composition of interfund balances as of June 30, 2008 is as follows (in thousands):

Receivable Fund	Payable Fund	Amount
General Fund	Combined Utility System	$ 316
	Airport System	7
		$ 323
Airport System	General Fund	$ 34
		$ 34
Convention and Entertainment Facilities	General Fund	$ 102
		$ 102
Combined Utility System	HAWC	$ 98,403
		$ 98,403
HAWC	Grants revenue	200
		$ 200

Note 13: Commitments and Contingencies

A. Litigation and Claims

The City is a defendant in various lawsuits and is aware of pending claims arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. That litigation includes lawsuits and claims alleging that the City caused personal injuries and wrongful deaths; class actions and other lawsuits and claims alleging discriminatory hiring and promotional practices and certain civil rights violations arising under the Federal Voting Rights Act; various claims from contractors for additional amounts under construction contracts; and claims involving property tax assessments and various other liability claims. Alleged damages in the lawsuits are approximately $214.9 million. The status of such litigation ranges from an early discovery stage to various levels of appeal of judgments both for and against the City. The amount of damages is limited in certain cases under the Texas Tort Claims Act and is subject to appeal. The City intends to defend itself vigorously against the suits. There is other threatened litigation for which an amount cannot be determined. The City typically utilizes the General Fund to liquidate claims and judgments. In the Statement of Net Assets, the City has recognized a liability of $60.2 million for potential litigation losses arising from various lawsuits.

In 2004, Houston voters approved two ballot propositions limiting City revenue growth. Proposition 1 generally limits annual growth in property tax revenues to the lesser of the actual revenues in the preceding fiscal year, plus 4.5 percent, or the revenues received in the previous fiscal year, plus the cumulative combined rates of inflation and the City's population growth. With the exception of grant monies, revenue received from other governmental entities and interfund transfers, Proposition 2 caps growth in all City revenues, including the General Fund, Special Revenue Funds and Enterprise Funds ("combined revenues"). Proposition 2 would require a 60 percent vote at a regular election before the City could increase combined revenues over the combined revenues for the preceding fiscal year as adjusted for rates of change in the consumer price index and population growth. Any combined revenues collected by the City in excess of the Proposition 2 restriction would be placed in a taxpayer relief fund. Although both propositions received a majority of votes in the 2004 election, it is the City's position that only Proposition 1 is effective because it received a higher number of favorable votes.

Supporters of Proposition 2 have sued in State District court to enforce the provisions of Proposition 2. The district court ruled in favor of the plaintiffs and ordered that both propositions be in effect. The City filed an appeal, and the Fourteenth Court of Appeals revised the district court, finding that the supporters of Proposition 2 did not have standing to sue. The appeals court gave plaintiffs an opportunity to amend their pleadings in the district court in an effort to plead facts sufficient to demonstrate standing. According to an analysis conducted by the City Controller's Office, the Fiscal Year 2006 budget complies with the requirements of both propositions. The City does not believe that the plaintiffs will be able to establish facts sufficient to demonstrate standing.

In 2007, Houston voters approved several ballot propositions including Proposition G, which eliminated some of the most serious concerns created by the potential application of Proposition 2 - by revising how the City's revenues limited by the Charter would be calculated (including the removal of the revenues of the City's Enterprise Funds from the revenues limited by the City Charter), and Proposition H, which allowed the City to raise revenues for police, fire, and emergency services in excess of the revenues allowed under any revenue limitations contained in the City Charter. A supporter of Proposition 2 has filed a second suit in State District court seeking to invalidate Propositions G and H. The court dismissed the lawsuit, and the plaintiff has appealed the ruling.

B. Environmental Liabilities

The City is aware of various sites contaminated by asbestos or other hazardous materials. The City has recorded accrued liabilities of $10.6 million, to be used for: assessment and remediation of asbestos, lead and mold; Phase I and II environmental site assessments and remediation; and remediation of radioactive material.

C. Commitments for Capital Facilities

At June 30, 2008, the City had appropriated but not yet spent from Capital Projects and Enterprise Funds approximately $1,491,377,000 for capital projects.

The City leased a tract of land for 30 years with a 30-year renewal option for $100 per year to The Houston Music Hall Foundation. On this site, the Houston Music Hall Foundation constructed the new music hall named the Hobby Center for the Performing Arts. Substantial completion occurred by October 31, 2002, as required by the agreement. The grand opening was in May of 2003. The Music Hall was to be conveyed to the City upon completion of various improvements. However, the Music Hall became involved in litigation with the contractor regarding these improvements and the transfer of the title was delayed. However, during the month of August 2008 the title was conveyed to the Mayor.

The City is obligated to pay from parking revenues $1.1 million per year for 30 years beginning on the commencement of the lease. The City's annual obligation is secured by a pledge of the parking revenues from the Civic Center and Tranquility Park Parking Garages equal to $1.2 million per year for 30 years.

D. Risk Management

The City carries fidelity coverage to comply with City ordinance, boiler and machinery insurance and purchases commercial property insurance with a per occurrence loss limit of $250 million. Property insurance provides deductibles as follows: $2.5 million per occurrence for all perils; 3% of the damaged insured value for windstorm or hail from a named storm, subject to $2.5 million minimum and a $20 million maximum; and 5% of the damaged insured value for flood, subject to a $5 million minimum and a $20 million maximum. Should a named storm event occur that involves the perils of windstorm and flood, the maximum deductible is $20 million. Although no losses were sustained in excess of the $150 million per occurrence loss limit in the last six years, Tropical Storm Allison (2001) caused damages in excess of the $5 million sub-limit to locations in the 100-year flood plain (Flood Zone A). Insurance reimbursed the City $32.6 million for property damage. The current sub-limit for flood is $75 million, of which $50 million may apply to Flood Zone A.

Self-insured claims are reported as liabilities in the accompanying financial statements when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. This determination is based on reported pending claims, estimates of claims incurred but not yet reported, actuarial reports and historical analysis. All claims are accounted for in the Government-wide Statement of Net Assets.

Claims that are expected to be paid with expendable, available financial resources are accounted for in the General Fund and the appropriate Enterprise Funds.

Through its Health Benefit Plan, the City has consistently purchased commercial insurance up to certain limitations in the event of adverse loss experience.

For unemployment claims, the City pays claims as they are settled. Unemployment claim activity is as follows:

	Unemployment Claim Activity	
	June 30, 2008	June 30, 2007
Unpaid claims, beginning of fiscal year	$123,964	$156,046
Incurred claims (including IBNRs)	583,298	562,418
Claim payments	(589,660)	(594,500)
Unpaid claims, end of fiscal year	$117,602	$123,964

E. Electricity Futures Contracts

Objective of the futures contracts. The City's electric supply agreement provides that the City will purchase electricity at prices based on market prices of natural gas at time of delivery. Therefore the City is exposed to significant price fluctuations in its electricity purchases. The agreement also allows the City to lock in fixed natural gas prices for future periods. To hedge the risk of increases and to be able to accurately budget future purchases, the City has entered into contracts to lock in fixed rates for the natural gas price component of future electricity purchases.

Terms: At June 30, 2008 the City had two outstanding agreements to cover natural gas purchases for August 2008 through June 2009. As of June 30, 2008 the aggregate notional amount of the agreements was 223 contracts or 2,230,000 million British thermal units (MMBtu's) of natural gas. Locked-in prices ranged from $7.52 to $9.06 per MMBtu.

Fair value: As of June 30, 2008 because natural gas futures prices had changed from the time of the agreements, the contracts had a total net fair value of $11,138,000.

Credit risk: As of June 30, 2008 the City is exposed to credit risk on the contracts for a total fair positive value of $11,138,000. The City's electrical provider is the Texas General Land Office ("GLO"), an agency of the State of Texas, which is rated AA1 by Moody's, AA by Standard and Poor's, and AA+ by Fitch.

Termination risk: GLO can terminate the electrical supply agreement (and related price agreements) only if the City defaults on its obligations. The City can unwind the price agreements at its discretion, paying or receiving market value credit at the time of the unwind.

F. Purchase Commitments - Renewable Energy Credits and Fixed Power Price Transactions

Objective of the Renewable Energy Credit Agreements: To diversify energy sources, to manage its utility costs, and as part of its commitment to protect the environment, the City has entered into contracts for fixed power price transactions and renewable energy credits ("RECs"). RECs means Renewable Energy Credits produced in Texas and obtained from any type of renewable resource qualified under Texas Rules, including solar, landfill gas, wind and other renewable resources.

Terms: At June 30, 2008 the City had four outstanding fixed power price transactions and RECs contracts with GLO to receive 1,753,000 RECs from 2008 through 2013. This represents about 25% of the City's anticipated electrical use. Each contract was for 10 MW of power at prices ranging from $69 per MWhr to $91 per MWhr.

Credit Risk: As of June 30, 2008 the City is exposed to credit risk on the contracts as to delivery. The City's electrical provider is the Texas General Land Office ("FLO"), an agency of the State of Texas, which is rated AA1 by Moody's, AA by Standard and Poor's, and AA+ by Fitch.

Termination risk: GLO can terminate the electrical supply agreement (and related price agreements) only if the City defaults on its obligations. The City can unwind the price agreements at its discretion, paying or receiving market value credit at time of the unwind.

G. Federal and State

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies, principally the federal and state governments. Any disallowed claims, including amounts already collected, could be a liability of the City.

Note 14: Related Organization Transactions

A. Metropolitan Transit Authority ("Metro")

The City and Metro have an interlocal agreement covering shared costs of street maintenance/construction and traffic control during the fiscal year ended June 30, 2008. The City received $78.273 million from Metro under this contract in the fiscal year ended June 30, 2008. The breakout was $47.277 million to Capital Projects, $30.489 million to General Fund, and $507 thousand to Special Revenues. None of these payments were for the prior contract year. In addition, the City paid Metro $418 thousand for transportation services.

B. Trinity River Authority ("TRA")

As described in Note 8C, the City and TRA have a long-term contract under which the City is obligated to pay debt service for certain bonds as well as certain maintenance and operating expenses for a TRA dam and reservoir. During the fiscal year ended June 30, 2008 the City paid $2.1 million for debt service and $3.1 million for maintenance and operating expenses under the terms of the contract.

C. Coastal Water Authority ("CWA")

The City has a long-term contract with Coastal Water Authority (CWA) for the water conveyance. During the fiscal year ended June 30, 2008, the City paid CWA $30.5 million for debt service and $20.3 million for maintenance and operating expenses.

D. Houston Convention Center Hotel Corporation

Upon formation of the Houston Convention Center Hotel Corporation (HCCHC), the City entered into various agreements with HCCHC, as part of the agreements, the City agreed to loan HCCHC $310 million of the convention & entertainment facility bonds, primarily for construction of the Hilton Americas Hotel. Repayment terms of the loan (including interest rates) coincide with the City's scheduled debt service payments

In accordance with the Interlocal Agreement and the hotel management agreement, after meeting certain other funding and reserve requirements, the City can require the distribution of a preferred return from available cash flow (as defined) equal to the preferred return amount (approximately $1 million for 2003, $20 million for 2004, and $25 million per year thereafter) minus the debt service for the applicable year. In December 2007, a preferred return payment of $2,405,970 was made to the City.

E. Component Units

As described in note 16, the City has a number of component units, most of which have fiscal years ended June 30, 2008. Three component units; Houston Convention Center Hotel Corporation (HCCHC), Houston Housing Financing Corporation (HHFC) and Miller Theatre Advisory Board, Inc (MTAB) have fiscal years ended December 31, 2007. Subsequent to December 31, 2007, the City received interest payments of $6,592 thousand from HCCHC, $58 thousand from HHFC and none from MTAB. These payments are necessary to reconcile to the City's due from component units as of June 30, 2008. The following governmental discretely presented component units had restatements for their most recent audited financial statements: (a) Greater Greenspoint Redevelopment Authority, (b) Greater Houston Convention Center and Visitors Bureau, and (c) Uptown Development Authority.

Note 15: Conduit Debt Obligations

To provide for the airport facilities, the City has issued eight series of Special Facility Revenue Bonds. These bonds are limited special obligations of the City, payable solely from and secured by a pledge of revenue to be received from agreements between the City and various third parties. The bonds do not constitute a debt or pledge of the faith and credit of the City and accordingly have not been reported in the accompanying financial statements, except for the City of Houston Special Facility Revenue Bonds (Automated People Mover System), Series 1997A, which are reported as an Inferior Lien Obligation because the City has contracted with Continental Airlines to operate certain facilities and pay related debt service. See Note 8D.

At June 30, 2008, the aggregate value of Special Facility Revenue Bonds outstanding was $638,465,000, which includes $49,700,000 of City of Houston Special Facility Revenue Bonds (Automated People Mover System), Series 1997A.

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Note 16: Major Discretely Presented Component Units

The following discretely presented component units represent major component units. For reporting purposes, the City considers a component unit to be major if assets, liabilities, revenues or expenses exceed 10% of that component unit's class and exceed 5% of all component units combined.

During fiscal year 2008, the City added two new discretely presented governmental component units (Fifth Ward Redevelopment Authority and Miller Theatre Advisory Board, Inc.) which resulted in the addition of $1,917 of beginning net assets. In addition, three discretely presented component units (Greater Greenspoint Redevelopment Authority, Greater Houston Convention & Visitor's Bureau and Upton Redevelopment Authority) restated their financial statements which had an additive affect to beginning net assets of $537.

Net Assets
Major Component Units - Discretely Presented Governmental
June 30, 2008
(in thousands)

	Greater Houston Convention & Visitor's Bureau	Houston Arts Alliance	Houston Downtown Park Corporation
Cash, receivable and other current assets	$ 7,629	$ 5,488	$ 510
Noncurrent assets	-	-	75
Capital assets, net of accumulated depreciation	161	14	56,987
Total assets	7,790	5,502	57,572
Current liabilities	2,266	2,376	-
Long-term liabilities	-	-	-
Total liabilities	2,266	2,376	-
Net assets			
Invested in capital assets, net of related debt	-	1,635	56,987
Restricted	-	-	-
Unrestricted (deficit)	5,524	1,491	585
Total net assets (deficit)	$ 5,524	$ 3,126	$ 57,572

(Continued)

Houston Parks Board	Midtown Redevelopment Authority	Uptown Revelopment Authority	Nonmajor Component Units	2008
$ 10,367	$ 51,570	$ 22,857	$ 118,404	$ 216,825
-	1,940	481	26,467	28,963
14,553	8,701	249	13,453	94,118
24,920	62,211	23,587	158,324	339,906
238	5,075	7,665	28,226	45,846
-	51,575	46,440	75,549	173,564
238	56,650	54,105	103,775	219,410
5,126	5,694	248	8,363	78,053
18,737	37,971	6,274	41,124	104,106
819	(38,104)	(37,040)	5,062	(61,663)
$ 24,682	$ 5,561	$ (30,518)	$ 54,549	$ 120,496

Change in Net Assets
Major Component Units - Discretely Presented Governmental
For the Year Ended June 30, 2008
(in thousands)

Component Units	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Greater Houston Convention & Visit. Bureau
Greater Houston Convention & Visitors Bureau	$ 15,823	$ 590	$ 16,537	$ -	$ 1,304
Houston Arts Alliance (frmly Cultural Arts Cou..)	13,237	-	12,238		-
Houston Downtown Park Corporation	4,103	-	42	-	-
Houston Parks Board	10,273	500	6,988	317	-
Midtown Redevelopment Authority	8,878	-	390	-	-
Uptown Development Authority	16,407	-	-	-	-
Nonmajor Component Units	43,621	1,386	9,161	-	-
Total component units	$ 112,342	$ 2,476	$ 45,356	$ 317	$ 1,304
General Revenues:					
Taxes					
Property taxes levied for general purposes					-
Intergovermental - grants					-
Unrestricted investment earnings					301
Other					-
Loss on sales of assets					-
Total general revenues, special items and transfers					301
Change in net assets					1,605
Net assets beginning					3,896
New component unit & restatement					23
Net assets ending					$ 5,524

(Continued)

Net (Expense) Revenue and Change In Net Assets

Houston Arts Alliance	Houston Downtown Park Corporation	Houston Parks Board	Midtown Redevelopment Authority	Uptown Redevelopment Authority	Non-Major Component Units	Total Component Units
$ -	$ -	$ -	$ -	$ -	$ -	$ 1,304
(999)	-	-	-	-	-	(999)
-	(4,061)	-	-	-	-	(4,061)
-	-	(2,468)	-	-	-	(2,468)
-	-	-	(8,488)	-	-	(8,488)
-	-	-	-	(16,407)	-	(16,407)
-	-	-	-	-	(33,074)	(33,074)
$ (999)	$ (4,061)	$ (2,468)	$ (8,488)	$ (16,407)	$ (33,074)	$ (64,193)
	-	-	11,276	14,604	40,597	66,477
122	-	3,617	-	-	-	3,739
-	-	537	1,003	398	2,015	4,254
1,254	-	-	176	-	1,831	3,261
-	-	101	-		-	101
1,376	-	4,255	12,455	15,002	44,443	77,832
377	(4,061)	1,787	3,967	(1,405)	11,369	13,639
2,749	61,633	22,895	1,594	(29,927)	41,563	104,403
-	-	-	-	814	1,617	2,454
$ 3,126	$ 57,572	$ 24,682	$ 5,561	$ (30,518)	$ 54,549	$ 120,496

Net Assets
Major Component Units - Discretely Presented Business-type
June 30, 2008
(in thousands)

	Houston Convention Center Hotel Corp.	Houston Housing Finance Corp.	Houston Zoo Inc.	Nonmajor Component Units	Total
Cash, receivable and other current assets	$ 53,212	$ 25,858	$ 35,234	$ -	$ 114,304
Noncurrent assets	2,473	14,001	-	-	16,474
Capital assets, net of accumulated depreciation	238,875	3,310	29,208	22,941	294,334
Total assets	294,560	43,169	64,442	22,941	425,112
Current liabilities	22,267	887	3,516	2,068	28,738
Long-term liabilities	296,461	1,603	-	20,674	318,738
Total liabilities	318,728	2,490	3,516	22,742	347,476
Net assets					
Invested in capital assets, net of related debt	(35,773)	-	-	695	(35,078)
Restricted	29,770	1,580	38,917	-	70,267
Unrestricted (deficit)	(18,165)	39,099	22,009	(496)	42,447
Total net assets (deficit)	$ (24,168)	$ 40,679	$ 60,926	$ 199	$ 77,636

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Change in Net Assets
Major Component Units - Discretely Presented Business-type
For the Year Ended June 30, 2008
(in thousands)

Component Units	Expenses	Charges for Services	Operating Grants and Contributions
Houston Convention Center Hotel Corp.	$ 82,673	$ 74,304	$ -
Houston Housing Finance Corp.	1,942	570	-
Houston Zoo Inc.	22,307	21,810	5,678
Nonmajor Component Units	516	365	-
Totals	$ 107,438	$ 97,049	$ 5,678

General Revenues:	
Taxes	
Property Taxes levied for general purposes	
Unrestricted investment earnings	
Other	
Total general revenues, special items, and transfers	
Change in net assets	
Net assets (deficit) beginning	
Net assets (deficit) ending	

Net (Expense) Revenue and Change in Net Assets

Houston Convention Center Hotel Corp.	Houston Housing Finance Corp.	Houston Zoo Inc.	Non-Major Component Units	Total
$ (8,369)	$ -	$ -	$ -	$ (8,369)
-	(1,372)	-	-	(1,372)
-	-	5,181	-	5,181
-	-	-	(151)	(151)
$ (8,369)	$ (1,372)	$ 5,181	$ (151)	$ (4,711)
-	750	-	-	750
2,157	2,207	506	-	4,870
10,597	201	154	-	10,952
12,754	3,158	660	-	16,572
4,385	1,786	5,841	(151)	11,861
(28,553)	38,893	55,085	350	65,775
$ (24,168)	$ 40,679	$ 60,926	$ 199	$ 77,636

Note 17: Subsequent Events

A. Tax and Revenue Anticipation Notes

On July 1, 2008, the City closed the sale of $80,000,000 Tax and Revenue Anticipation Notes ("TRANS"), Series 2008. The proceeds of the TRANS will be used to pay working capital expenditures until tax revenues are received in early 2008. The stated interest rate was 3.0%, and the average yield was 1.70%. The notes will mature on June 30, 2009.

B. On October 8, 2008, the City authorized the issuance of supplemental Tax and Revenue Anticipation Notes ("TRANS"), for an amount not to exceed $95,000,000. The City can elect to pay interest based on a 1 Month Libor or prime rate. Currently, there are $40 million of supplemental notes outstanding. These notes can be prepaid any time prior to the June 30, 2009 maturity.

C. Taxable Pension Deferred Interest Certificate

On October 1, 2008 the City elected to defer $25,500,000 in interest payments on its $300,000,000 Collateralized Pension Obligation Note, and to allocate such deferred interest to the Uncollateralized Deferred Interest Certificate ("the Certificate"), as allowed by the ordinance authorizing issuance of the Note. The Certificate will bear interest at the greater of a) 8.5%, or b) the yield on April 1 of each year for the Treasury obligation maturing closest to December 1, 2033, plus a predefined rate adjustment. Under the authorizing ordinance, the City is allowed to defer up to $150,000,000 in interest on the Note. Under the authorizing ordinance, the City must pay down the Certificate by December 1, 2033.

D. Public Improvement Refunding Bonds

On November 13, 2008, the City issued $324,030,000 of Public Improvement Refunding Bonds, Series 2008A, at rates ranging from 4.0 to 5.5%. Average yield was 5.24%. The bonds are due in varying amounts from March 2012 to March 2038. Proceeds were used to currently refund $320,705,000 of General Obligation Commercial Paper Series D and F; and to pay costs of issuance.

E. Credit Market Conditions

Beginning in September 2008, certain City of Houston outstanding commercial paper notes and variable rate demand notes were not successfully remarketed as a result of the national credit crisis and downgrade or potential downgrade of certain of the City's liquidity providers. Notes that were not successfully remarketed were held by the City's liquidity providers. As of December 12, 2008, all of the City's commercial paper notes have been successfully remarketed, while approximately $107 million of its $1 billion outstanding variable rate notes are held by liquidity providers. The notes held by the liquidity providers are at rates of interest currently within budgeted amounts for Fiscal Year 2009.

F. Pension Obligation Bonds

On December 4, 2008, the City priced $382,630,000 of Pension Obligation Refunding Bonds, Series 2008A and $20,190,000 of Pension Obligation Bonds, Series 2008B. The City expects to close on the bonds on January 8, 2009. The stated interest rate and yield on the Series 2008A and Series 2008B bonds was 6.29%. Proceeds of the 2008A bonds will be used to refund the $300,000,000 Collateralized Pension Obligation Note, related Uncollateralized Deferred Interest Certificates, and the $35,050,000 Taxable Pension Obligation Note and to pay costs of issuance. Proceeds of the 2008B bonds will be used to fund the Houston Police Officers Pension System Unfunded Actuarial Accrued Liability and pay costs of issuance.

Required Supplementary Information - (unaudited)

CITY OF HOUSTON, TEXAS
GENERAL OPERATING FUND
Schedule of Budgeted and Actual Revenues and Expenditures
For the Year Ended June 30, 2008
amounts expressed in thousands
(unaudited)

	Budgeted Amounts		Actual Budget	Variance with Final Budget-
	Original	Final	Basis	Pos (Neg)
Revenues				
Taxes and assessments				
Property Taxes	$ 796,368	$ 796,368	$ 830,889	$ 34,521
Industrial Assessments	15,700	15,700	17,787	2,087
Sales Tax	477,217	477,217	495,173	17,956
Franchise Tax	184,476	184,476	190,193	5,717
Mixed Beverage Tax	9,874	9,874	10,479	605
Bingo Tax	289	289	256	(33)
Total taxes and assessments	1,483,924	1,483,924	1,544,777	60,853
Licenses and permits				
General	12,700	12,700	13,943	1,243
Health Permits	6,338	6,338	6,898	560
Total licenses and permits	19,038	19,038	20,841	1,803
Charges for services				
Ambulance service	26,000	26,000	24,735	(1,265)
Parking	228	228	193	(35)
Services performed for other funds				
Direct	47,281	47,281	41,395	(5,886)
Indirect	14,354	14,354	10,950	(3,404)
Rents and royalties	1,166	1,166	1,307	141
Others	15,656	14,561	13,252	(1,309)
Total charges for services	104,685	103,590	91,832	(11,758)
Intergovernmental - grants	34,038	33,990	32,950	(1,040)
Fines and forfeits				
Municipal Courts	42,572	42,572	37,140	(5,432)
Others	2,758	2,758	4,491	1,733
Total fines and forfeits	45,330	45,330	41,631	(3,699)
Contributions	-	-	-	-
Interest	11,950	11,950	16,992	5,042
Other				
Sale of Property	472	472	1,572	1,100
Other	7,902	7,950	11,142	3,192
Total Other	8,374	8,422	12,714	4,292
Total revenues	1,707,339	1,706,244	1,761,737	55,493
Other financing sources (uses)				
Transfers in	9,500	10,595	11,219	624
Sale of capital assets	4,150	4,150	4,003	(147)
Other financing sources (uses)	35,000	35,000	35,000	-
Total other financing sources (uses	48,650	49,745	50,222	477
Total revenues and other financing source	$ 1,755,989	$ 1,755,989	$ 1,811,959	$ 55,970

* See note to Required Supplementary Information*

CITY OF HOUSTON, TEXAS
GENERAL OPERATING FUND
Schedule of Budgeted and Actual Revenues and Expenditures
For the Year Ended June 30, 2008
amounts expressed in thousands
(unaudited)

	Budgeted Amounts		Actual	Variance with Final Budget-
	Original	Final	Budget Basis	Pos (Neg)
General government				
Legislative and executive				
Legislative - Council				
Personnel services	4,458	4,387	4,513	(126)
Other current expenditures	611	536	344	192
Equipment acquisition	-	35	31	4
Total legislative - council	5,069	4,958	4,888	70
Legislative - Mayor's Office				
Personnel services	2,752	2,767	2,725	42
Other current expenditures	250	249	172	77
Equipment acquisition	-	-	-	-
Total executive - mayor's office	3,002	3,016	2,897	119
Total legislative and executive	8,071	7,974	7,785	189
Affirmative Action				
Personnel services	2,146	2,150	1,981	169
Other current expenditures	139	147	141	6
Equipment acquisition	-	3	4	(1)
Total affirmative action	2,285	2,300	2,126	174
Judicial				
Municipal Courts Judges				
Personnel services	4,464	4,512	4,429	83
Other current expenditures	360	360	320	40
Equipment acquisition	-	-	-	-
Total municipal court judges	4,824	4,872	4,749	123
Municipal Courts Administration				
Personnel services	11,592	12,691	12,623	68
Other current expenditures	3,637	3,644	3,660	(16)
Equipment acquisition	47	40	30	10
Total municipal court administration	15,276	16,375	16,313	62
Total judicial	20,100	21,247	21,062	185
Elections	2,400	1,820	1,820	-
Finance administration				
Controller				
Personnel services	5,612	5,643	5,592	51
Other current expenditures	1,099	1,099	1,004	95
Equipment acquisition	-	-	-	-
Total controller	6,711	6,742	6,596	146
Administrative and Regulatory Affairs				
Personnel services	17,382	17,415	16,732	683
Other current expenditures	363	2,950	2,783	167
Equipment acquisition	4,032	66	150	(84)
Total administrative and regulatory affairs	21,777	20,431	19,665	766
Finance				
Personnel services	6,086	4,676	4,309	367
Other current expenditures	-	3,671	3,861	(190)
Equipment acquisition	-	30	1	29
Total finance	6,086	8,377	8,171	206
Information Technology				
Personnel services	11,472	12,667	12,871	(204)
Other current expenditures	2,139	4,301	4,441	(140)
Equipment acquisition	15	10	1	9
Total information technology	13,626	16,978	17,313	(335)
Audits	40	15	7	8
Bond and Legal	1,285	1,158	836	322
Total finance administration	49,525	53,701	52,588	1,113

See note to required Supplementary Information

CITY OF HOUSTON, TEXAS
GENERAL OPERATING FUND
Schedule of Budgeted and Actual Revenues and Expenditures
For the Year Ended June 30, 2008
amounts expressed in thousands
(unaudited)

	Budgeted Amounts		Actual	Variance with Final Budget-
	Original	Final	Budget Basis	Pos (Neg)
Legal				
Personnel services	12,577	12,519	12,454	65
Other current expenditures	1,582	1,707	1,314	393
Equipment acquisition	-	-	-	-
Total legal	14,159	14,226	13,768	458
City Secretary				
Personnel services	626	629	549	80
Other current expenditures	115	115	81	34
Equipment acquisition	-	-	-	-
Total city secretary	741	744	630	114
Planning and Development				
Personnel services	7,711	7,552	6,827	725
Other current expenditures	625	652	591	61
Equipment acquisition	-	103	133	(30)
Total planning and development	8,336	8,307	7,551	756
Human Resources				
Personnel services	2,368	2,340	2,200	140
Other current expenditures	321	360	259	101
Total human resources	2,689	2,700	2,459	241
Total general government	108,306	113,019	109,789	3,230
Public safety				
Police				
Personnel services	561,096	564,761	567,603	(2,842)
Other current expenditures	39,630	43,005	41,800	1,205
Equipment acquisition	134	507	1,492	(985)
Total police	600,860	608,273	610,895	(2,622)
Fire				
Personnel services	363,080	363,139	356,613	6,526
Other current expenditures	24,695	25,142	24,547	595
Equipment acquisition	-	210	840	(630)
Total fire	387,775	388,491	382,000	6,491
Total public safety	988,635	996,764	992,895	3,869
Public Works				
Administration				
Personnel services	27,955	26,928	26,561	367
Other current expenditures	63,957	65,060	59,018	6,042
Equipment acquisition	89	166	215	(49)
Total administration	92,001	92,154	85,794	6,360
General Services				
Personnel services	12,719	12,443	12,615	(172)
Other current expenditures	30,412	31,196	32,014	(818)
Equipment acquisition	20	56	103	(47)
Total general services	43,151	43,695	44,732	(1,037)

See note to required Supplementary Information

CITY OF HOUSTON, TEXAS
GENERAL OPERATING FUND
Schedule of Budgeted and Actual Revenues and Expenditures
For the Year Ended June 30, 2008
amounts expressed in thousands
(unaudited)

	Budgeted Amounts		Actual	Variance with Final Budget-
	Original	Final	Budget Basis	Pos (Neg)
Solid Waste				
Personnel services	32,049	31,770	30,906	864
Other current expenditures	38,266	38,628	38,418	210
Equipment acquisition	900	1,121	1,116	5
Total solid waste	71,215	71,519	70,440	1,079
Total public works	206,367	207,368	200,966	6,402
Health				
Personnel services	42,151	38,084	38,874	(790)
Other current expenditures	8,080	11,795	10,998	797
Equipment acquisition	-	1,033	648	385
Total health	50,231	50,912	50,520	392
Housing				
Personnel services	245	270	265	5
Other current expenditures	268	268	207	61
Total housing	513	538	472	66
Parks and Recreation				
Personnel services	39,067	37,746	35,943	1,803
Other current expenditures	23,698	25,803	27,579	(1,776)
Equipment acquisition	-	62	41	21
Total parks and recreation	62,765	63,611	63,563	48
Library				
Personnel services	23,969	23,007	22,962	45
Other current expenditures	4,481	4,577	4,463	114
Equipment acquisition	6,374	7,395	7,420	(25)
Total library	34,824	34,979	34,845	134
Retiree Benefits				
Hospital and life insurance	19,134	18,500	18,506	(6)
Total retiree benefits	19,134	18,500	18,506	(6)
Other current expenditures				
Tax appraisal fees	6,018	6,320	6,320	-
Limited-purpose Annexation Districts	22,005	24,000	25,113	(1,113)
Claims and judgments	6,000	8,934	11,794	(2,860)
Membership dues	726	726	710	16
Advertising and promotion	225	175	183	(8)
Consultants	183	483	471	12
Miscellaneous support services	13,429	10,042	6,411	3,631
Total other current expenditures	48,586	50,680	51,002	(322)
Debt service				
Debt service principal	-	-	1,399	(1,399)
Debt service interest	4,752	4,514	4,514	-
Total debt service	4,752	4,514	5,913	(1,399)
Total expenditures	1,524,113	1,540,885	1,528,471	12,414
Other financing sources (uses)				
Transfers out	244,360	263,778	263,597	181
Total other financing sources (uses)	244,360	263,778	263,597	181
Total expenditures and other financing uses	$ 1,768,473	$ 1,804,663	$ 1,792,068	$ 12,595

See note to required Supplementary Information

CITY OF HOUSTON, TEXAS
REQUIRED RECONCILIATION FOR GENERAL FUND
BUDGET vs. GAAP PRESENTATION
For the Year Ended June 30, 2008
amounts expressed in thousands
(*unaudited*)

Revenues		
Actual amounts (budgetary basis) "revenues" from the budgetary comparison schedules	$	1,761,737
Revenues of non-budgeted funds		
Equipment Acquisition		54
Building Security		1,013
Grant Matching Fund		445
Vehicle Maintenance		115
Total revenues of non-budgeted funds		1,627
Interest on pooled investments from non-budgeted revenues		1,670
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	$	1,765,034
Expenditures		
Actual amounts (budgetary basis) "expenditures" from the budgetary comparison schedules	$	1,528,471
Expenditures of non-budgeted funds		
Equipment Acquisition		69,791
Building Security		1,023
Signal Maintenance		35
Fleet Maintenance		82
Special Projects		349
Grant Matching Fund		20
Total expenditures of non-budgeted funds		71,300
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	$	1,599,771
Other financing sources (uses)		
Actual amounts (budgetary basis) "other financing sources and uses" from the budgetary comparison schedules	$	(213,375)
Proceeds from Issuance of Debt		95,623
Transfers In of non budgeted funds		5,896
Total other financing sources and uses as reported on the statement of revenues, expenditures, and changes in fund balances--governmental funds	$	(111,856)

See note to Required Supplementary Information

CITY OF HOUSTON, TEXAS
REQUIRED NOTES TO THE SUPPLEMENTARY INFORMATION
June 30, 2008
(*Unaudited*)

1. General Budget Policies

During January of each year, the Mayor, with City Council input, establishes budget guidelines. All departments of the City submit requests for appropriations to the Mayor and the City's Department of Finance and Administration so that a budget may be prepared. Typically during June, the City Controller certifies that funds are available for a continuing appropriation and the budget is proposed to City Council. City Council holds public hearings and a final budget is normally adopted by June 30th. A final appropriation ordinance is adopted later in the fiscal year and may include budget revisions or amendments.

The legal level of budgetary control is the departmental level within each fund, even though the budget is prepared by fund, department, and expenditure category. The Mayor is authorized to transfer unlimited budgeted amounts within departments and amounts between departments, provided such transfers do not exceed 5% of an expenditure category. Expenditure categories are personnel services, other current expenditures and capital outlay. Appropriations related to funds with annual budgets lapse at year-end except for Capital Outlay appropriations, which cover multiple years.

On April 30, 2008, City Council approved the Fiscal Year 2008 general appropriation ordinance in the amount of $1.805 billion for the General Fund.

Annual operating budgets are adopted for the General Operating Fund, the Debt Service Fund, the Special Revenue Funds (except for the Grants Revenue Fund, Disaster Recovery, Health Special Fund and the Housing Special Fund) and the Proprietary Funds. The budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. Budgets for proprietary funds are prepared on the accrual basis, but focus on expenses relating to maintenance and operations, and equipment purchases and, accordingly, exclude depreciation and other allocations related to income determination.

The following provides actual fiscal year 2008 results for both budgeted and non-budgeted Special Revenue Funds (in thousands):

	Revenues	Expenditures	Other Sources (Uses)
Budgeted Special Revenue Funds	$ 115,035	$ 137,567	$ 41,163
Non-budgeted Disaster Recovery Fund	2,365	-	(1,020)
Non-budgeted Grants Revenue Fund	190,603	180,484	(144)
Non-budgeted Health and Housing	2,474	1,522	89
Non-budgeted Other Funds	11,455	7,609	561
Total Special Revenue Funds - Actual	$ 321,932	$ 327,182	$ 40,649

2. General Fund Budgetary Highlights

While revenues were only $55 million above budget (pgs. 117-120), there were some significant differences between some of the budgeted and actual revenue numbers. Some of the increases/decreases from budget include:

- $61 million increase in taxes and assessments
- $2 million increase in licenses and permits
- $12 million decrease in charges for services
- $4 million decrease in fines and forfeits
- $5 million increase in interest

Only Public Safety and Public Works saw significant changes in budgeted and actual expenditures for the fiscal year. In Public Safety, the Police department's expenditures increased by $3 million, while the Fire department's expenditures decreased by $6 million for a total decrease of $4 million. In Public Works, the Public Works department's expenditures decreased by $6 million, while the General Services department increased by $1 million and Solid Waste department decreased by $1 million, for a total decrease of $6 million.

CITY OF HOUSTON, TEXAS
REQUIRED PENSION SYSTEM
SUPPLEMENTARY INFORMATION
June 30, 2008
(*unaudited)*

Houston Firefighters' Pension System Supplementary Information (unaudited)
Schedule of Funding Progress *(in millions)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus UAAL) (b-a)	Funded Ratio (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 2001	$1,863.1	$1,650.8	($212.3)	113%	$164.3	(129%)
July 1, 2002*	$1,922.4	$1,970.1	$47.7	98%	$190.6	25%
July 1, 2004	$2,000.3	$2,266.8	$266.5	88%	$181.5	147%
July 1, 2005	$2,119.2	$2,461.1	$341.9	86%	$192.1	178%
July 1, 2006	$2,325.0	$2,670.9	$345.9	87%	$218.7	158%
July 1, 2007	$2,633.6	$2,892.3	$258.7	91%	$232.4	111%

* No actuarial study was required or conducted for July 1, 2003.

Houston Municipal Pension System Supplementary Information (unaudited)
Schedule of Funding Progress *(millions)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus UAAL) (b-a)	Funded Ratio (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 2002	$1,519.7	$2,515.2	$995.5	60%	$399.8	249%
July 1, 2003	$1,510.3	$3,278.3	$1,768.0	46%	$390.3	453%
July 1, 2004	$1,501.2	$2,633.8	$1,132.6	57%	$366.1	309%
July 1, 2005	$1,777.7	$2,725.3	$947.6	65%	$404.6	234%
July 1, 2006	$1,867.3	$2,894.3	$1,027.0	65%	$422.5	243%
July 1, 2007	$2,193.7	$3,128.7	$935.0	70%	$448.9	208%

Houston Police Officer's Pension System Supplementary Information (unaudited)
Schedule of Funding Progress *(millions)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus UAAL) (b-a)	Funded Ratio (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 2001	$2,226.3	$2,306.4	$80.1	97%	$264.2	30%
July 1, 2002	$2,337.1	$2,593.7	$256.6	90%	$286.1	90%
July 1, 2003	$2,394.4	$2,874.7	$480.3	83%	$300.4	160%
July 1, 2004	$2,466.0	$3,339.2	$873.2	74%	$329.8	265%
July 1, 2005*	$2,508.8	$3,393.0	$884.2	74%	$321.1	275%
July 1, 2007	$3,004.9	$3,857.7	$852.8	78%	$336.0	254%

* No actuarial study was required or conducted for July 1, 2006.

CITY OF HOUSTON, TEXAS
REQUIRED OTHER POST EMPLOYMENT BENEFITS
SUPPLEMENTARY INFORMATION
June 30, 2008
(*unaudited*)

Houston Other Post Employment Benefits Supplementary Information (unaudited)
Schedule of Funding Progress *(millions)*

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL UAAL) (b-a)	Funded Ratio (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
June 30, 2006	$54.5	$326.5	$272.0	16.7%	$1,090.1	25%

CITY OF HOUSTON, TEXAS
COMBINED UTILITY SYSTEM
Statement of Net Assets
June 30, 2008
(With comparative amounts for 2007)
amounts expressed in thousands

	2008	2007
Assets		
Current assets		
Equity in pooled cash and investments	$ 635,593	$ 645,791
Receivables, net of allowances		
Accounts receivable	96,728	68,023
Special assessments receivable	93	93
Due from other funds	1,544	-
Due from other governments	4,866	5,158
Inventory	6,168	5,633
Prepaid items	3,727	3,111
Total current assets	748,719	727,809
Noncurrent Assets		
Due from other funds	96,859	-
Deferred charges for issuance cost	56,737	46,762
Total noncurrent restricted assets	153,596	46,762
Other assets		
Amounts held by other governments	10,058	14,520
Capital assets		
Land	115,478	101,371
Buildings, improvements and equipment	204,679	198,733
Plants, lines and rights	8,053,794	7,619,503
Construction in progress	413,610	507,292
Water rights	456,915	456,915
Total capital assets	9,244,476	8,883,814
Less accumulated depreciation and amortization	(4,210,358)	(4,038,861)
Net capital assets	5,034,118	4,844,953
Total noncurrent assets	5,197,772	4,906,235
Total assets	$ 5,946,491	$ 5,634,044

(Continued)

CITY OF HOUSTON, TEXAS
COMBINED UTILITY SYSTEM
Statement of Net Assets
June 30, 2008
(With comparative amounts for 2007)
amounts expressed in thousands

	2008	2007
Liabilities		
Current Liabilities		
Accounts payable	$ 87,152	$ 38,726
Accrued payroll liabilities	4,908	4,153
Accrued interest payable	30,590	24,473
Contracts payable	18,155	60,091
Due to other funds	316	682
Due to other governments	1,088	4,897
Advances and deposits	36,239	32,568
Claims and judgments	1,257	1,173
Compensated absences	7,252	6,374
Deferred Electricity Note	2,610	2,453
Revenue bonds payable	37,783	26,613
Total current liabilities	227,350	202,203
Noncurrent liabilities		
Revenue bonds payable	4,982,679	4,379,524
Claims and judgments	1,278	1,333
Compensated absences	12,783	11,204
Contracts payable	188,384	206,482
Commercial paper	156,500	440,200
Arbitrage rebate	4,842	2,427
Deferred Electricity Note	-	2,610
Pension note payable	51,600	51,600
Municipal pension trust liability	48,306	44,627
Other post employment benefits	19,856	-
Deferred revenue	275,502	158,334
Pension obligation bonds payable	3,382	3,382
Total noncurrent liabilities	5,745,112	5,301,723
Total liabilities	5,972,462	5,503,926
Net Assets		
Invested in capital assets, net of related debt	(226,413)	(56,682)
Restricted net assets		
Restricted for maintenance and operations	63,450	62,674
Restricted for capital improvements	42,886	5,158
Unrestricted	94,106	118,968
Total net assets	$ (25,971)	$ 130,118

CITY OF HOUSTON, TEXAS
COMBINED UTILITY SYSTEM
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2008
(With comparative amounts for 2007)
amounts expressed in thousands

	2008	2007
Operating Revenues		
Water/Sewer Billing	648,269	615,465
Total operating revenue	648,269	615,465
Operating Expenses		
Maintenance and operating	346,665	315,348
Depreciation and amortization	220,190	257,722
Total operating expenses	566,855	573,070
Operating income (loss)	81,414	42,395
Nonoperating revenue (expenses)		
Investment income	35,435	36,014
Other revenue	31,517	36,617
Other expenses		(1)
Interest on long-term debt	(267,504)	(242,282)
Loss on disposal of assets	(12,009)	(3,478)
Contributions in	2,343	-
Total Nonoperating revenues (expenses)	(210,218)	(173,130)
Income (loss) before contributions and transfers	(128,804)	(130,735)
Capital contributions	42,862	20,746
Transfers in	1,020	-
Transfers out	(71,167)	(76,944)
Total transfers	(70,147)	(76,944)
Change in net assets	(156,089)	(186,933)
Total net assets, July 1	130,118	317,051
Total net assets, June 30	$ (25,971)	$ 130,118

CITY OF HOUSTON, TEXAS
COMBINED UTILITY SYSTEM
Statement of Cash Flows
For the Year Ended June 30, 2008
(With comparative amounts for 2007)
amounts expressed in thousands

	2008	2007
Cash flows from operating activities		
Receipts from customers	$ 623,236	$ 627,465
Payments to employees	(127,065)	(119,284)
Payments to suppliers	(123,271)	(156,998)
Internal activity-payments to other funds	(17,032)	(4,111)
Claims paid	(459)	(1,650)
Other revenues	31,517	36,030
Net cash provided by (used in) operating activities	386,926	381,452
Cash flows from investing activities		
Interest income on investments	35,435	36,014
Transfer from investments to equity pool cash and investments	-	393,668
Net cash provided by (used in) investing activities	35,435	429,682
Cash flows from capital and related financing activities		
Retirement of revenue bonds	(107,416)	(95,947)
Proceeds from issuance of revenue bonds - net	131,436	103,583
Proceeds from issuance of commercial paper	220,000	280,000
Interest expense on debt	(207,739)	(235,793)
Proceeds from disposition of assets	14,178	7,247
Contributed capital	112,407	5,512
Deferred bond issuance cost	(17,139)	(3,063)
Retirement of contractual obligation	(122,788)	-
Acquisition of property, plant and equipment	(385,352)	(323,968)
Net cash used for capital and related financing activities	(362,413)	(262,429)
Cash flows from noncapital financing activities		
Transfers to debt service fund	(25,804)	(24,211)
Transfers to other funds	(44,342)	(52,733)
Net cash used in noncapital financing activities	(70,146)	(76,944)
Net decrease in cash and cash equivalents	(10,198)	471,761
Cash and cash equivalents, July 1	645,791	174,030
Cash and cash equivalents, June 30	$ 635,593	$ 645,791
Non cash transactions		
Unrealized gain (loss) on investments	3,820	2,305
Amortization expense	13,013	8,384
Capital additions included in liabilities	38,524	17,255
Contributed Capital	42,863	18,410
Capitalized interest expense	18,566	19,027
Total non cash transactions	$ 116,786	$ 65,381
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 81,414	$ 42,395
Depreciation and amortization	220,190	257,722
Other post employemnt benefits	19,856	-
Other revenues	31,516	36,617
Changes in assets and liabilities		
Accounts receivable	(28,704)	8,761
Due from other funds	-	1,924
Due from other governments	4,511	(2,679)
Inventory & prepaid insurance	(1,151)	(1,310)
Accounts payable	48,426	26,418
Accrued payroll liabilities	755	2,223
Due to other funds	316	(743)
Arbitrage rebate	2,415	2,427
Advances and deposits	3,671	3,238
Claims and judgments-workers' compensation	28	(1,522)
Compensated absences	2,457	2,027
Pension obligation payable	3,679	6,735
Deferred revenues	-	(585)
Other long-term liabilities	(2,453)	(2,196)
Net cash provided by operating activities	$ 386,926	$ 381,452

APPENDIX B

ECONOMIC AND DEMOGRAPHIC CHARACTERISTICS

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APPENDIX B

ECONOMIC AND DEMOGRAPHIC CHARACTERISTICS

This Appendix contains a brief discussion of certain selected economic and demographic data on the City of Houston, Texas (the "City") and surrounding areas. Information in this Appendix has been obtained from sources that are believed to be reliable; however, such information is subject to revision and adjustment, and no representation is made with respect to the accuracy or completeness of such information.

The following data focuses primarily on four geographic areas, the Houston Primary Metropolitan Statistical Area (the "Houston PMSA"), the Consolidated Metropolitan Statistical Area (the "Houston CMSA"), the Greater Houston Area and Harris County, the county in which the City primarily lies. The Greater Houston Area includes all of Harris County and parts of six surrounding counties. The Houston PMSA consists of six counties: Chambers, Fort Bend, Harris, Liberty, Montgomery and Waller. The Houston CMSA consists of eight counties: Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery and Waller.

IT SHOULD BE NOTED THAT THE FOUR GEOGRAPHIC AREAS DESCRIBED ABOVE ENCOMPASS POPULATIONS AND AREAS WHICH FAR EXCEED THE POPULATION AND AREA OF THE CITY, SO THAT THE FOLLOWING DATA MAY SET FORTH STATISTICS AND TRENDS WHICH DO NOT NECESSARILY REFLECT STATISTICS AND TRENDS APPLICABLE SOLELY TO THE CITY ITSELF. IN ADDITION, INVESTORS SHOULD NOTE THE DATA CONTAINED IN THIS APPENDIX MAY FLUCTUATE MORE OR LESS IN SUBSEQUENT YEARS THAN IN PRIOR YEARS AND SUCH FLUCTUATIONS MAY BE COUNTER TO THE TRENDS AND STATISTICS EXHIBITED IN THE FOLLOWING TABLES.

HOUSTON-SUGARLAND-BAYTOWN METROPOLITAN STATISTICAL AREA POPULATION ESTIMATES[a]
1998-2007

Calendar Year	Population Estimates (In Thousands)	Annual % Change
2007.....	5,628.10	2.19%
2006.....	5,507.56	3.50
2005.....	5,321.50	2.16
2004.....	5,208.98	2.17
2003.....	5,098.38	2.21
2002.....	4,988.37	2.73
2001.....	4,888.88	2.44
2000.....	4,740.42	2.06
1999.....	4,644.53	2.39
1998.....	4,534.98	2.45

Source: Population Division, U.S. Census Bureau.
[a] The City previously provided population numbers for the City's PMSA. The City believes that the MSA population numbers better reflect the economic relationship of the region.

HOUSTON POPULATION ESTIMATES (WITHIN THE CITY LIMITS)
1998-2007

Year[a]	Population Estimates (In Thousands)	Annual % Change
2007	2,208.2	1.79%
2006	2,169.2	4.48
2005	2,076.2	0.84
2004	2,058.9	1.26
2003	2,033.4	1.03
2002	2,012.7	0.90
2001	1,994.8	0.83
2000	1,978.4	7.17
1999	1,846.0	0.92
1998	1,829.1	1.20

Source: Population Estimates Program, Population Division, U.S. Census Bureau (1998-2007).

[a] Figures are as of July of each year. The 2005 population figure does not include any population increases that may be attributable to the relocation of residents from Louisiana, Alabama and Mississippi as a result of Hurricane Katrina.

HOUSTON CONSUMER PRICE INDEX
ALL URBAN CONSUMERS 1999-2008

Calendar Year	Average Index	Annual % Change
2008	190.0	3.4%
2007	183.9	1.8
2006	180.6	2.8
2005	175.6	3.6
2004	169.5	3.5
2003	163.7	2.8
2002	159.2	0.3
2001	158.8	3.0
2000	154.2	3.7
1999	148.7	1.3

Source: Federal Reserve Bank of Dallas, March 19, 2009.

HOUSTON PRIMARY METROPOLITAN STATISTICAL AREA

NON-AGRICULTURAL WAGE AND SALARY EMPLOYMENT (SEASONALLY ADJUSTED)
AVERAGE NUMBER OF JOBS FOR ALL EMPLOYMENT SECTORS
1999-2008

Calendar Year	Annual Average (In Thousands)
2008	2,590.5
2007	2,532.2
2006	2,434.1
2005	2,337.1
2004	2,278.7
2003	2,262.9
2002	2,277.4
2001	2,282.4
2000	2,243.6
1999	2,191.4

Source: University of Houston, Center for Public Policy, February 2009.

HOUSTON PRIMARY METROPOLITAN STATISTICAL AREA

UNEMPLOYMENT RATE
(NOT SEASONALLY ADJUSTED)
% UNEMPLOYED
1999-2008

Calendar Year	Annual Average
2008	4.8%
2007	4.3
2006	5.0
2005*	5.6
2004	6.2
2003	6.8
2002	6.1
2001	4.7
2000	4.4
1999	4.8

*Estimated.
Source: University of Houston, Center for Public Policy, February 2009.

PORT OF HOUSTON TONNAGE
TOTAL CARGO
1998-2007

Calendar Year	Short Tons
2007	225,000,000
2006	219,100,000
2005	212,400,000
2004	202,000,000
2003	190,923,145
2002	177,560,718
2001	185,050,168
2000	186,567,246
1999	158,828,203
1998	169,070,334

Source: Port of Houston Authority.

HOUSTON CONSOLIDATED METROPOLITAN STATISTICAL AREA
ANNUAL HOUSING STARTS
1999-2008

Calendar Year	Units		
	Single Family	Multi-Family	Total
2008	28,111	14,526	42,637
2007	42,028	21,134	63,162
2006	55,120	16,570	71,690
2005	51,085	11,080	62,165
2004*	45,039	10,858	55,897
2003	41,995	16,761	58,756
2002	34,640	12,401	47,041
2001	34,311	7,183	41,494
2000	31,120	7,590	38,710
1999	27,270	11,990	39,260

*Estimated. Source: CDS Market Research, February 2009.

GREATER HOUSTON AREA
APARTMENT OCCUPANCY RATES[(a)]
1999-2008

Calendar Year	Occupancy Rate
2008	86.3%
2007	87.4
2006	88.1
2005	90.6
2004	85.8
2003	87.1
2002	89.7
2001	91.5
2000	90.7
1999	89.4

(a) Physical occupancy based on calendar year.
Source: CB Richard Ellis (1999-2008)

HOUSTON HOTEL OCCUPANCY RATES
1999-2008

Calendar Year	Average Occupancy Rate
2008	68.5%
2007	67.4
2006	68.9
2005	69.5
2004	61.9
2003	60.4
2002	63.2
2001	68.9
2000	65.6
1999	63.6

Source: The PKF Consulting, February 2009.

CITY OF HOUSTON BUILDING PERMITS
1999-2008

New Non-Residential[a]

Calendar Year	Number of Permits Issued	Dollar Value (In Thousands)
2008	2,778	$2,186,599
2007	2,991	1,777,311
2006	2,944	1,342,131
2005	3,231	1,150,103
2004	1,218	673,381
2003	3,217	731,725
2002	2,976	864,773
2001	3,291	1,379,047
2000	3,418	891,856
1999	3,620	1,133,165

[a] Privately owned.

Source: City of Houston, Public Works and Engineering.

CITY OF HOUSTON BUILDING PERMITS
1999-2008
New Residential[a]

	Single Family		Multi-Family	
Calendar Year	Number of Permits Issued	Dollar Value (In Thousands)	Number of Permits Issued	Dollar Value (In Thousands)
2008	3,749	$847,394	237	$439,346
2007	6,480	1,307,714	444	712,494
2006	7,628	1,330,846	538	588,083
2005	7,296	1,152,592	274	359,663
2004	5,958	943,913	440	344,397
2003	5,140	819,294	472	510,474
2002	4,152	666,003	696	524,060
2001	4,320	681,451	308	323,373
2000	4,655	764,656	339	238,869
1999	4,064	657,106	323	259,005

[a] Privately Owned.

Source: City of Houston, Public Works and Engineering.

HOUSTON PRIMARY METROPOLITAN STATISTICAL AREA
GENERAL PURPOSE OFFICE SPACE ACTIVITY[a]
1999-2008

Calendar Year	Net Rentable Area[b]	Net Absorption[c]	Annual Vacancy Rate	Average Rents (Per Square Foot)[d]
		(Millions of Square Feet)		
2008	185.10	2.7	11.90%	$23.57
2007	180.76	3.3	10.98	21.61
2006	178.21	0.3	14.48	18.09
2005	177.88	1.2	14.46	17.78
2004	178.14	0.2	16.35	17.81
2003	147.31	0.8	16.44	21.01
2002	147.23	1.1	16.55	20.66
2001	143.40	1.3	13.20	22.81
2000	143.57	2.7	13.89	18.81
1999	143.93	1.6	13.00	17.58

[a] Based on buildings greater than 29,999 square feet. (Excludes single tenant government-owned and medical office buildings).
[b] Decrease in 1999 due to change in the market base (37 single-tenant buildings).
[c] Millions of square feet net absorption is the difference between the total number of square feet that are leased (excluding renewals of leases) and the total number of square feet that have become vacant in the year.
[d] Average asking rental rates are quoted on a gross basis.

Source: CB Richard Ellis, The Outlook Report.

CITY OF HOUSTON
AVIATION PASSENGER AND AIR FREIGHT TRENDS
1999-2008

The following table presents total passenger arrivals and departures and air freight (in pounds) for George Bush Intercontinental Airport, William P. Hobby Airport, and Ellington Airport for the years indicated.

	Passenger Arrivals & Departures			Air Freight[a]
Calendar Year	Domestic	International	Domestic and International	Total Domestic And International
2008	42,525,054	7,960,133	50,485,187	836,486,374
2007	44,094,573	7,722,990	51,817,563	864,395,702
2006	43,688,377	7,411,010	51,099,387	810,143,748
2005	41,065,006	6,909,038	47,974,089	768,561,131
2004	38,472,465	6,385,139	44,857,604	784,125,513
2003	36,471,462	5,620,391	42,091,853	740,645,402
2002	36,357,296	5,668,225	42,025,521	731,476,709
2001	37,824,235	5,636,613	43,460,848	700,998,886
2000	38,777,484	5,653,282	44,430,766	748,959,263
1999	36,955,352	5,057,760	42,013,112	739,514,721

[a] Air Freight is in pounds and excludes airmail.
Source: City of Houston, Airport System.

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APPENDIX C

DEFINITIONS

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APPENDIX C

DEFINITIONS

As used in this Official Statement, the following terms shall have the following meanings, unless the context clearly indicates otherwise:

"Additional First Lien Bonds" means the additional first lien revenue bonds permitted to be issued by the City pursuant the Master Ordinance. See "ADDITIONAL BONDS."

"Additional Second Lien Bonds" means the additional second lien revenue bonds permitted to be issued by the City pursuant to the Master Ordinance. See "ADDITIONAL BONDS."

"Additional Bonds Test" means the terms of the Master Ordinance relating to the issuance of Additional First Lien Bonds and Additional Second Lien Bonds as described in the section captioned "ADDITIONAL BONDS — Additional First and Second Lien Obligations."

"Adjustable Rate Bonds" or **"Adjustable Rate Obligations"** means any System Bonds or other System Obligations that initially bear interest at an adjustable or variable rate of interest, including Adjustable Rate Bonds which may be converted to bear a rate of interest fixed to maturity. The Series 2004B and Series 2004C Bonds are Adjustable Rate Bonds initially issued in as auction rate securities.

"Ambac" means Ambac Assurance Corporation or any successor thereto. Ambac is the Bond Insurer for the Series 2004C Bonds.

"Average Annual Debt Service Requirements" means the average of the annual Debt Service Requirements (taking into account all mandatory principal redemption requirements) scheduled to occur in then current Fiscal Year and future Fiscal Years for the particular System Obligations (First Lien Bonds, Second Lien Bonds, or otherwise) for which such calculation is made.

"Board Bonds" means the Water and Sewer System Junior Lien Revenue Bonds purchased or to be purchased by the Texas Water Development Board on a parity with the Previous Ordinance Bonds outstanding under the terms of the Previous Ordinance. The Master Ordinance provided that the City could issue a specified amount of Board Bonds included in a then current commitment from the Texas Water Development Board to the City to purchase bonds in such specified amount. The City has issued the full amount of Board Bonds permitted under the Master Ordinance. For further information, see "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Bond Insurer" means a third party financial institution that provides a Credit Agreement in the form of a municipal bond insurance policy. See the section captioned "BOND INSURANCE."

"Business Day" means a day other than (i) a Saturday and Sunday, (ii) a day on which the Paying Agent/Registrar or banks and trust companies in New York, New York are authorized or required to remain closed, or (iii) a day on which the New York Stock Exchange is closed.

"City" means the City of Houston, Texas, and, where appropriate, the City Council thereof and any successor to the City as owner of the System.

"Combined Utility System" or "CUS" means all properties, facilities, improvements, equipment, interests, rights and powers constituting the combined water and sewer system of the City, and all future extensions, replacements, betterments, additions, improvements, enlargements, acquisitions, purchases and repairs to the Combined Utility System, including without limitation, all those heretofore or hereafter acquired as a result of the annexation and dissolution of water districts or the acquisition of the properties or assets of any other public, private or non-profit entities. The Combined Utility System shall not include any Special Project. The Combined Utility System shall include other utility systems provided for in Chapter 1502 of the Texas Government Code which the City may from time to time elect to combine with the Combined Utility System so long as the revenues of such other utility systems are included in Gross Revenues under the Master Ordinance.

"Commercial Paper Notes" has the meaning give to such term in the section captioned "SYSTEM DEBT AND CHARGES— Commercial Paper Program."

"Credit Agreement" means any agreement between the City and a third party institution pursuant to which such third party institution issues a letter of credit, municipal bond insurance policy, line of credit, standby purchase agreement, surety policy, surety bond or other guarantee for the purpose of enhancing the creditworthiness or liquidity of any of the City's obligations pursuant to any System Bonds or Qualified Hedge Agreements and in consideration for which the City may agree to pay, but solely from Net Revenues, (i) periodic payments for the availability of such Credit Agreement and/or (ii) reimbursements or repayments of any amounts advanced under such Credit Agreement, together with interest and other stipulated costs and charges related to such amounts advanced. Obligations of the City pursuant to a Credit Agreement shall be deemed to be, and shall be included within, the Debt Service Requirements for the series of System Bonds to which the Credit Agreement relates. Further, obligations of the City to make payments under a Credit Agreement as reimbursements or repayments of amounts paid or advanced under such Credit Agreement for interest on or principal of any System Bonds (including interest and other stipulated costs and charges related to such amounts advanced) shall be deemed to be payments of interest on or principal of such System Bonds. Each Credit Agreement shall be deemed to be a part of the Bonds of the series to which it relates for the purpose of securing its payment or repayment by the pledge of Net Revenues as provided in the Master Ordinance. Unless specifically provided for in a Supplemental Ordinance, issuers of Credit Agreements shall not be treated as Owners of System Bonds for purposes of any voting rights to approve amendments or to direct the exercise of any remedies under the Master Ordinance; provided that a Supplemental Ordinance may provide that, so long as an institution that issues a municipal bond insurance policy insuring a series of System Bonds is not in default of its payment obligations under such policy, such institution may, under the terms of the Supplemental Ordinance, at all times be deemed to be the exclusive owner of such series of System Bonds for the purpose of all approvals, consents, waivers, or exercise of any action and the direction of all remedies. For purposes of the Master Ordinance, Credit Agreements shall not include a Reserve Fund Surety Policy.

"CWA" means the Coastal Water Authority. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Debt Service Requirements" means, as of any period of time for which such calculation applies, an amount equal to the sum of the following for any such period and with respect to all or any portion of the System Bonds:

A. Current interest scheduled to be paid during such period on such System Bonds, except to the extent that provision for the payment of such interest has been made by (i) appropriating for such purpose amounts sufficient to provide for the full and timely payment of such interest either from proceeds of System Bonds, from interest earned or to be earned thereon, from other System funds other than Net Revenues, or from any combination of such sources and (ii) depositing such amounts (except in the case of interest to be earned, which shall be deposited as received) into a fund or account for capitalized interest, the proceeds of which are required to be transferred as needed into the First Lien Bond Interest and Sinking Fund or the Second Lien Bond Interest and Sinking Fund, as the case may be, plus

B. That portion of the principal of, or compounded interest on, such System Bonds scheduled to be payable during such period (either at maturity or by reason of scheduled mandatory redemptions, but after taking into account all prior optional and mandatory Bond redemptions);

provided, however, that the following rules shall apply to the computation of Debt Service Requirements on any series of System Bonds that are Short Term Obligations, Adjustable Rate Obligations and Refundable Obligations:

(i) For any series of System Bonds issued as Short Term Obligations under the Master Ordinance pursuant to a program designated by the City as a commercial paper or similar program, Debt Service Requirements shall be computed on the assumption that the principal amount shall continuously be refinanced under such program and remain outstanding until the first Fiscal Year for which interest on such Short Term Obligations has not been capitalized or otherwise funded or provided for, at which time (which shall not be beyond the term of such program) it shall be assumed that the outstanding principal amount thereof shall be refinanced with a series of System Bonds of the same lien which shall be assumed to be amortized over a remaining period not to exceed 30 years from the original issue date of such Short Term

Obligations and shall be assumed to be amortized in such a manner that the Debt Service Requirements in any 12-month period are substantially equal to the Debt Service Requirements for any other 12-month period, and shall be assumed to bear interest at a fixed interest rate estimated by the City's financial advisor in a written certificate delivered to the City at the time of such calculation to be the interest rate such series of System Bonds would bear if issued on such terms on the date of such estimate;

(ii) For any series of System Bonds issued as Adjustable Rate Bonds, it shall be assumed that such System Bonds will bear interest at a rate calculated as follows: (a) with respect to compliance with the Rate Covenant, for any such series of System Bonds then Outstanding, at the actual interest rate derived from such variable or adjustable interest rate formula or computation, or the actual interest rate payable on such series of System Bonds, on the date of such calculation, and (b) with respect to compliance with the Reserve Fund Requirements and compliance with the Additional Bonds Test, for any such System Bonds then Outstanding or proposed to be issued, at an interest rate estimated by the City's financial advisor in a written certificate delivered to the City at the time of such calculation to be the average rate of interest such System Bonds would bear if issued as long-term bonds, in the same principal amount and with the same priority of lien, bearing interest at fixed rates based on the average life of the Adjustable Rate Obligations;

(iii) For the purpose of calculating the Debt Service Requirements on any series of System Bonds issued as Refundable Obligations, such System Bonds shall be assumed to be amortized in substantially equal annual amounts to be paid for principal and interest over an assumed amortization period not to exceed 30 years from the original issue date of such series of System Bonds at an interest rate estimated by the City's financial advisor in a written certificate delivered to the City at the time of such calculation to be the average rate of interest such series of System Bonds would bear if issued as long-term bonds in the same principal amount with the same priority of lien, bearing interest at fixed rates to be amortized over 30 years;

(iv) With respect to Crossover Refunding Bonds, the aggregate Debt Service Requirements thereon until the Crossover Refunding Bonds Break Date shall be disregarded; and

(v) With respect to System Bonds to be redeemed with the proceeds of Crossover Refunding Bonds, Debt Service Requirements thereon after the Crossover Refunding Bonds Break Date shall be disregarded.

Debt Service Requirements shall be calculated on the assumption that no System Bonds Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of scheduled principal maturities or scheduled mandatory redemptions of such System Bonds, except as provided above for Short Term Obligations.

Credit Agreements shall cause Debt Service Requirements to be increased only to the extent of scheduled payments and charges for the availability of the Credit Agreement without regard to any repayment or reimbursement obligations or interest thereon or other stipulated costs or charges related thereto.

Debt Service Requirements shall include debt service requirements on Previous Ordinance Bonds, including without limitation, Outstanding Board Bonds at the time of such calculation.

Qualified Hedge Agreements shall cause Debt Service Requirements to be (i) increased by the amount of any scheduled payments and charges for the availability of the Qualified Hedge Agreement, (ii) decreased by the amount of any scheduled interest payments on the related Bonds which the City's financial advisor certifies in a written certificate delivered to the City to be modified pursuant to the Qualified Hedge Agreement, and (iii) increased by the gross payments of the City under the Qualified Hedge Agreement (without regard to netting); provided, however, that the Debt Service Requirements for any variable or adjustable payment obligation of the City under the Qualified Hedge Agreement shall be calculated in accordance with the provisions contained in paragraph (ii) above of the definition of Debt Service Requirements, as certified by the City's financial advisor in a written certificate delivered to the City; and provided further, that any obligation of the City to make termination payments or deliver collateral under a Qualified Hedge Agreement shall be paid as a Third Lien Obligation or an obligation inferior and subordinate to Third Lien Obligations.

"Designated Index" means the United States Consumer Price Index for all Urban Consumers (also known as the CPI-U) for the Houston-Galveston-Brazoria, Texas Metropolitan Area (1982-1984=100), as published by the Bureau of Labor Statistics, U.S. Department of Labor (but if such is subject to adjustment later, then the later adjusted index, together with any correlation factor necessary to relate the later adjusted index to the earlier index, as published by the entity publishing the index, shall be used), or if such publication is discontinued, the Designated Index shall then refer to comparable statistics on changes in the cost of living for urban consumers as the same may be computed and published (on the most frequent basis available) by an agency of the United States or by a responsible financial periodical of recognized authority, which agency or periodical shall be selected by the City.

"Discretionary Debt Service" shall have the meaning given to such term in the section captioned "SYSTEM DEBT AND CHARGES — Discretionary Debt Service."

"DTC" means The Depository Trust Company of New York, New York or any successor securities company.

"First Lien Bonds" means each series of First Lien Bonds from time to time hereafter issued, but only to the extent such First Lien Bonds remain Outstanding within the meaning of the Master Ordinance.

"Fiscal Year" means the City's fiscal year, which currently runs from July 1 to June 30, but which may be changed from time to time by the City.

"Fourth Lien Obligations" means System Obligations authorized by the Master Ordinance that are payable after First Lien Bonds, Second Lien Bonds and Third Lien Obligations.

"Gross Revenues" means all revenues and income of every nature now and hereafter derived or received by the City from the operation and ownership of the components of the System; the interest income from the investment or deposit of money in the funds created pursuant to the Master Ordinance and the Previous Ordinance; and any other revenues hereafter pledged to the payment of System Obligations issued pursuant to the Master Ordinance. Gross Revenues shall not include Restricted Receipts. The term "Gross Revenues" shall also include all payments received by the City, except for termination payments and receipts of collateral, pursuant to Qualified Hedge Agreements.

"HAWC" means the Houston Area Water Corporation, a public non-profit local government corporation, formed on behalf of the City pursuant to Chapter 431 of the Texas Transportation Code, as amended and Chapter 394 of the Local Government Code, as amended, pursuant to Resolution No. 2000-42 of the City Council of the City approved on August 23, 2000. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE" and "EFFECTS OF SUBSIDENCE."

"Interest Payment Date" means the dates designated in the Supplemental Ordinance. The Interest Payment Dates for the Series 2009A Bonds are November 15 and May 15, commencing November 15, 2009.

"Junior Lien Bonds" means City of Houston, Texas Junior Lien Revenue Bonds issued under the Previous Ordinance. See also the definition for "PREVIOUS ORDINANCE BONDS."

"Maintenance and Operation Expenses" means the reasonable and necessary expenses of operation and maintenance of the System, including all salaries, wages, pension fund contributions, interest, labor, materials, repairs and extensions necessary to render efficient service (but only such repairs and extensions as, in the judgment of the governing body of the City, are necessary to keep the System in operation and render adequate service to the City and the inhabitants thereof, or such as might be necessary to meet some physical accident or conditions which would otherwise impair the System Bonds or other System Obligations), and all payments (including payments of amounts equal to all or a part of the debt service on bonds issued by other political subdivisions and authorities of the State of Texas) under contracts which are now or hereafter defined for a system such as the System as operating expenses by the Legislature of Texas. Depreciation shall never be considered as a Maintenance and Operation Expense. Maintenance and Operation Expenses shall include, without limitation, all payments under contracts for the impoundment, conveyance or treatment of water or otherwise which are now or hereafter treated as operating expenses under the laws of the State of Texas and the treatment of such payments as Maintenance and Operation Expenses shall not be affected in any way if, subsequent to the entering into such contracts, the City acquires as a

part of the System title to any properties or facilities used to impound, convey or treat water under such contracts, or if the City contracts to acquire title to such properties or facilities as a part of the System upon the final payment of debt service on the bonds issued to finance such properties or facilities.

"Maintenance and Operation Expenses under the Previous Ordinance" means Maintenance and Operation Expenses of the Water and Sewer System required to be paid under the Previous Ordinance.

"Master Ordinance" means the Master Bond Ordinance adopted by City Council on April 21, 2004, and all amendments thereof and supplements thereto.

"Maximum Annual Debt Service Requirements" means the greatest combined Debt Service Requirements (taking into account all mandatory principal redemption requirements) scheduled to occur in any particular future Fiscal Year or in the then current Fiscal Year for the particular System Bonds (First Lien Bonds, Second Lien Bonds, Previous Ordinance Bonds, or any combination of the foregoing) for which such calculation is made.

"mgd" means million gallons per day.

"Net Revenues" means (i) all Gross Revenues remaining after deducting Maintenance and Operation Expenses, plus (ii) any Restricted Receipts deposited to the Revenue Fund that may be used to pay Debt Service Requirements on System Obligations.

"NHCRWA" means the North Harris County Regional Water Authority. See "EFFECTS OF SUBSIDENCE."

"Officers' Pricing Certificate" means a certificate or certificates to be signed by the Mayor and the City Controller pursuant to a Supplemental Ordinance containing pricing information and other terms for one or more series of System Bonds and delivered to the City Secretary, in substantially the form attached as an exhibit to such Supplemental Ordinance.

"Outstanding," when used with reference to the Previous Ordinance Bonds, First Lien Bonds, Second Lien Bonds, Third Lien Obligations or Fourth Lien Obligations, as the case may be, means, as of a particular date, all such System Obligations theretofore delivered except: (a) any such obligation canceled by or on behalf of the City at or before said date; (b) any such obligation defeased pursuant to the defeasance provisions of the Previous Ordinance or the Supplemental Ordinance authorizing its issuance, or otherwise defeased as permitted by applicable law; and (c) any such obligation in lieu of or in substitution for which another obligation shall have been delivered pursuant to the ordinance authorizing the issuance of such obligation.

"Owner" or **"Registered Owner,"** when used with respect to any System Obligation, means the person or entity (including any entity acting as an underwriter of System Bonds) in whose name such System Obligation is registered in the Register. Any reference to a particular percentage or proportion of the Owners of the System Obligations of a particular class or series of System Bonds means the Owners at a particular time of the specified percentage or proportion in aggregate principal amount of all System Bonds or the System Obligations of such class or series then Outstanding.

"Paying Agent/Registrar" or **"Paying Agent"** means a bank, trust company, or other entity designated pursuant to a Supplemental Ordinance as the agent of the City to receive and disburse to Owners of the System Bonds the principal and premium, if any, and interest on the System Bonds. The City reserves the option to act as it own Paying Agent/Registrar. The Bank of New York Mellon Trust Company, National Association, Houston, Texas, has been designated as the Paying Agent/Registrar for the Series 2009A Bonds.

"Previous Ordinance" means, collectively, the City's ordinances, as amended, heretofore or hereafter adopted, that authorized or shall authorize the issuance of the Previous Ordinance Bonds. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Previous Ordinance Bonds" means on any date all of the City's Water and Sewer System Junior Lien Revenue Bonds, if any, that remain Outstanding under the Previous Ordinance, including Outstanding Board Bonds. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Previously Issued Contract Revenue Bonds" has the meaning given to such term in the section captioned "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Qualified Hedge Agreement" means, without limitation, (i) any contract known as or referred to or which performs the function of an interest rate swap agreement, currency swap agreement, forward payment conversion agreement, or futures contract; (ii) any contract providing for payments based on levels of, or changes or differences in, interest rates, currency exchange rates, or stock or other indices; (iii) any contract to exchange cash flows or payments or series of payments; (iv) any type of contract called, or designed to perform the function of, interest rate floors, collars, or caps, options, puts, or calls, to hedge or minimize any type of financial risk, including, without limitation, payment, currency, rate, or other financial risk; and (v) any other type of contract or arrangement that the City determines is to be used, or is intended to be used, to manage or reduce the cost of any System Bonds, to convert any element of any System Bonds from one form to another, to maximize or increase investment return, to minimize investment return risk, or to protect against any type of financial risk or uncertainty (in the case of clauses (i) through (v), whether from or initiated at the option of the City or the counterparty). A Qualified Hedge Agreement may only be entered into with an institution that has long term credit ratings, or the obligations of which are unconditionally guaranteed by a financial institution with long term credit ratings, in one of the two highest generic rating categories by at least one Rating Agency then rating the System Bonds. Any obligations of the City to make scheduled payments under a Qualified Hedge Agreement shall be included within the definition of Debt Service Requirements for the series of System Bonds to which the Qualified Hedge Agreement relates. Further, obligations of the City to make payments under a Qualified Hedge Agreement derived from or resulting from a fluctuation in hedged interest rates or in the value of any index of payment shall be deemed to be payments of interest on the Bonds to which the Qualified Hedge Agreement relates, and each Qualified Hedge Agreement shall be deemed to be a part of the System Bonds of the series to which it relates for the purpose of securing its payment by the pledge of Net Revenues as provided in the Master Ordinance, except that any obligation of the City to make termination payments that are not payable in installments over the remaining term of the relevant transaction or to deliver collateral shall be paid as a Third Lien Obligation or an obligation inferior and subordinate to Third Lien Obligations. However, issuers of and counterparties to Qualified Hedge Agreements shall not be treated as Owners of System Bonds for purposes of any voting rights to approve amendments under the Master Ordinance.

"Rate Covenant" has the meaning given to such term in the section captioned "SECURITY FOR THE BONDS — Rate Covenant."

"Rating Agency" means Fitch Ratings, Moody's Investors Service, Standard & Poor's, or any other nationally recognized rating agency.

"Refundable Obligations" means any series of System Obligations 25% or more of the original principal amount of which is due on any date; provided that, in calculating the principal amount of such System Obligations due or required to be redeemed, prepaid or otherwise paid on any date, such principal amount shall be reduced to the extent that all or any portion of such amount is required to be redeemed or amortized on any date.

"Register" means the registration books maintained by a Paying Agent/Registrar for System Obligations issued under a Supplemental Ordinance.

"Required Payments" means any payments required to be made under the Previous Ordinance, including without limitation (i) all payments required to be made by the City as Maintenance and Operation Expenses under the Previous Ordinance, including without limitation under outstanding contracts on the effective date of this Master Ordinance for the impoundment, conveyance, or treatment of water or otherwise which are treated as operating expenses under the laws of the State of Texas, and (ii) all payments required to be made by the City to pay debt service requirements on Previous Ordinance Bonds in accordance with the terms of the Previous Ordinance and to comply with the reserve fund requirements of the Previous Ordinance.

"Reserve Fund Participants" means any series of System Bonds for which the City elects to fund a shared First Lien Bond Reserve Fund or Second Lien Bond Reserve Fund, as appropriate.

"Reserve Fund Requirements" means the amount required by a Supplemental Ordinance to be deposited, accumulated and reaccumulated and maintained in the First Lien Bond Reserve Fund, the Second Lien Bond Reserve Fund and any reserve funds created for Third Lien Obligations or Fourth Lien Obligations.

"Reserve Fund Surety Policy" means any surety bond or any insurance policy which has liquidity features equivalent to an irrevocable and unconditional letter of credit, or any irrevocable and unconditional letter of credit, deposited in a reserve fund created pursuant to the Master Ordinance in lieu of or in partial substitution for monies on deposit therein, which is rated at the time of deposit of such Reserve Fund Surety Policy in the highest rating category by each Rating Agency rating the Outstanding System Bonds to which such Reserve Fund Surety Policy relates at the time of deposit of such Reserve Fund Surety Policy.

"Restricted Receipts" means (i) revenues related to the System received by the City that pursuant to law or contractual agreements that may not be used to pay Maintenance and Operation Expenses and (ii) any interest earnings on the revenues described in clause (i) above.

"Second Lien Bonds" means each series of Second Lien Bonds from time to time hereafter issued, but only to the extent such Second Lien Bonds remain Outstanding within the meaning of the Master Ordinance.

"Series 2009A Bond Reserve Fund Requirement" means an amount equal to 50% of the Maximum Annual Debt Service Requirements on (i) all First Lien Bonds issued through the date of the Supplemental Ordinance authorizing the Series 2009A Bonds, and (ii) all subsequent issues of First Lien Bonds that elect to fund a shared Bond Reserve Fund on a parity with the Bond Reserve Fund funded by such Supplemental Ordinance. All such issues electing such Series 2009A Bond Reserve Fund Requirement shall be entitled to a parity claim on the funds deposited in such shared Bond Reserve Fund.

"Short Term Obligations" means each series of bonds, notes and other obligations issued pursuant to a commercial paper or other similar financing program under the Master Ordinance, the payment of principal of which is scheduled to be payable within one year from the date of issuance and is contemplated to be refinanced through the issuance of additional System Obligations.

"Special Project" means, to the extent permitted by law, any existing or future utility system property, improvement or facility declared by the City not to be part of the System, for which the costs of acquisition, construction, and installation are paid from proceeds of a financing transaction other than the issuance of bonds payable from ad valorem taxes or revenues of the System and for which all maintenance and operation expenses are payable from sources other than ad valorem taxes or revenues of the System, but only to the extent that and for so long as all or any part of the revenues or proceeds of which are or will be pledged to secure the payment or repayment of such costs of acquisition, construction, and installation under such financing transaction.

"System" has the same meaning given to the term "Combined Utility System."

"System Bonds" means any or all of the System Obligations issued as First Lien Bonds or Second Lien Bonds, or both, as the context may indicate.

"System Obligations" means Previous Ordinance Bonds and obligations authorized pursuant to the Master Ordinance, including, without limitation, First Lien Bonds, Second Lien Bonds, Third Lien Obligations, Fourth Lien Obligations, Credit Agreements and Qualified Hedge Agreements.

"Supplemental Ordinance" means any ordinance supplementing the Master Ordinance to provide for the issuance of System Bonds or other System Obligations authorized by the Master Ordinance.

"Surety" means a third party financial institution that provides a Reserve Fund Surety Policy.

"TCEQ" means the Texas Commission on Environmental Quality and any successor thereto.

"Third Lien Obligations" means System Obligations authorized by the Master Ordinance that are payable after First Lien Bonds and Second Lien Bonds.

"TRA" means the Trinity River Authority. See "REQUIRED PAYMENTS UNDER PREVIOUS ORDINANCE."

"Water and Sewer System" means all properties, facilities, improvements, equipment, interests, rights and powers constituting the water and sewer system of the City. See also the section captioned "THE CITY AND THE SYSTEM — General" and the definition for the term "Combined Utility System."

"WHCRWA" means the West Harris County Regional Water Authority. See "EFFECTS OF SUBSIDENCE."

APPENDIX D

EXCERPTS OF MASTER ORDINANCE

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APPENDIX D

EXCERPTS OF MASTER ORDINANCE

The following are selected provisions of the Master Ordinance. These excerpts should be qualified by reference to other portions of the Master Ordinance referred to elsewhere in this Official Statement, and all amended and restated references and summaries pertaining to the Master Ordinance in this Official Statement are separately and in whole, qualified by reference to the exact terms of the Master Ordinance, a copy of which may be obtained from the City of Houston. Unless otherwise indicated, any references to sections listed below are to sections contained in the Master Ordinance, and Section and Article headings contained in the following excerpts are to Sections and Articles contained in the Master Ordinance. As used in this APPENDIX D, the Master Ordinance is referred to herein as "this Ordinance," "System Bonds" are referred to as the "Bonds" and "System Obligations" are referred to as the "Obligations." Other defined terms used in this APPENDIX D shall have the meanings given such terms in APPENDIX C to this Official Statement, unless the context of the use of such term herein indicates otherwise.

ARTICLE III

TERMS OF THE BONDS

Section 3.1. Name.

The name, amount, purpose, and legal authorization for each series of Bonds shall be specified in the Supplemental Ordinance authorizing such series.

Section 3.2. Numbers; Date, and Denomination.

Each series of Bonds shall be numbered and dated and shall be in principal denominations as specified in the authorizing Supplemental Ordinance.

Section 3.3. Terms.

Each Series of Bonds shall bear interest from the dates and at the rates per annum and shall mature on the date or dates to be set forth in the authorizing Supplemental Ordinance. Bonds may bear interest at a fixed, variable, auction, term or commercial paper rate or any other rate provided for in the authorizing Supplemental Ordinance.

Section 3.4. Redemption Prior to Maturity.

Each Series of Bonds may be subject to redemption in the manner provided in the authorizing Supplemental Ordinance.

Section 3.5. Manner of Payment, Characteristics, Execution, and Authentication.

Each authorizing Supplemental Ordinance shall designate a Paying Agent/Registrar for such series of Bonds. The Bonds shall be payable, shall have the characteristics, shall be signed and executed, shall be sealed, and shall be authenticated, all as provided and in the manner indicated in the authorizing Supplemental Ordinance. To the extent required by Texas law, Bonds initially delivered shall also have attached or affixed thereto the registration certificate of the Comptroller of Public Accounts of the State of Texas. If any officer of the City whose manual or facsimile signature shall appear on the Bonds, as provided in the authorizing Supplemental Ordinance, shall cease to be such officer before the authentication of the Bonds or before the delivery of the Bonds, such manual or facsimile signature shall nevertheless be valid and sufficient for all purposes as if such officer had remained in such office.

Any portion of the text of any Bonds may be set forth on the reverse thereof, with an appropriate reference thereto on the face of the Bond. The definitive Bonds shall be printed, lithographed, engraved, or typewritten or produced by any combination of these methods, or produced in any other manner, all as determined by the officers executing such Bonds as evidenced by their execution thereof, but the initial Bonds submitted to the Attorney General of Texas may be typewritten, photocopied, or otherwise reproduced.

The approving legal opinion of Bond Counsel for the Bonds, may be printed on the back of the Bonds over the certification of the City Secretary of the City which may be executed in facsimile. CUSIP numbers and a statement of insurance, if any, also may be printed on applicable Bonds, but errors or omissions in the printing of the opinion, the numbers, or the statement of insurance shall have no effect on the validity of the Bonds.

ARTICLE IV

FORM OF BONDS

Each series of Bonds shall be in substantially the form set out in the Supplemental Ordinance, with such omissions, insertions and variations as may be permitted or required pursuant to the terms of such ordinance for each series of the Bonds (including appropriate variations required for any Bonds issued as capital appreciation bonds).

ARTICLE V

SECURITY AND SOURCE OF PAYMENT FOR ALL BONDS

Section 5.1. Pledge Securing Bonds.

The City hereby covenants and agrees that Gross Revenues of the System shall, as collected and received by the City, be deposited and paid into the special funds hereinafter established, after satisfying any requirements of the Previous Ordinance. For so long as the Previous Ordinance Bonds remain Outstanding, the City hereby covenants and agrees that gross revenues (as defined under the Previous Ordinance) shall be applied in the manner set forth in the Previous Ordinance to provide for the payment of all Required Payments, and then Gross Revenues shall be applied in the manner hereinafter set forth in order to provide for the payment of all remaining Maintenance and Operation Expenses that have not been paid as Required Payments. Net Revenues shall be applied to provide for the payment of principal of, interest on and any redemption premiums on the First Lien Bonds, any parity Obligations under Qualified Hedge Agreements and Credit Agreements, and all expenses of paying same; to provide for the payment of principal of, interest on and any redemption premiums on the Second Lien Bonds, any parity Obligations under Qualified Hedge Agreements and Credit Agreements, and all expenses of paying same; and to provide for the disposition of the remaining Net Revenues in accordance with this Ordinance. The First Lien Bonds shall constitute special obligations of the City that shall be payable solely from and shall be equally and ratably secured by a lien on the Net Revenues as collected and received by the City from the operation and ownership of the System, which Net Revenues shall, in the manner herein provided, be set aside in the First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund for and pledged to the payment of the First Lien Bonds as hereinafter provided, and the First Lien Bonds shall be, in all respects, on a parity with and of equal dignity with one another. The Second Lien Bonds shall constitute special obligations of the City that shall be payable solely from and, subject only to the senior and superior lien on Net Revenue pledged to the payment of the First Lien Bonds and other obligations payable from the First Lien Bond Interest and Sinking Fund, shall be equally and ratably secured by a lien on the Net Revenues, as collected and received by the City from the operation and ownership of the System, which Net Revenues shall, in the manner herein provided, be set aside in the Second Lien Bond Interest and Sinking Fund and the Second Lien Bond Reserve Fund for and pledged to the payment of the Second Lien Bonds as hereinafter provided, and the Second Lien Bonds shall be in all respects on a parity with and of equal dignity with one another. The Owners of the First Lien Bonds and the Second Lien Bonds shall never have the right to demand payment of either the principal of, interest on or any redemption premium on the First Lien Bonds or the Second Lien Bonds out of any funds raised or to be raised by taxation. Chapter 1208, Texas Government Code, applies to the issuance and delivery of the First Lien Bonds and the Second Lien Bonds and the pledge of the Net Revenues granted under this Ordinance, and such pledge is therefore valid, effective, and perfected.

Section 5.2. Rates and Charges.

So long as any Bonds remain Outstanding, the City shall fix, charge, and collect rates and charges for the use and services of the System which are calculated to be fully sufficient to produce Net Revenues in each Fiscal Year at least equal to the greater of:

(a) 120% of the combined Debt Service Requirements scheduled to occur in such Fiscal Year on all Previous Ordinance Bonds and First Lien Bonds then Outstanding, or

(b) 110% of the combined Debt Service Requirements scheduled to occur in such Fiscal Year on all Previous Ordinance Bonds, First Lien Bonds, and Second Lien Bonds then Outstanding,

plus an amount equal to the sum of all deposits required to be made to the First Lien Bond Reserve Fund and to the Second Lien Bond Reserve Fund in such Fiscal Year; provided that in calculating the Net Revenues required by paragraphs (a) and (b) above all or any portion of such Net Revenues that exceed 100% of the combined Debt Service Requirements may be attributed to amounts on deposit in the CUS General Purpose Fund that are available to pay Debt Service Requirements pursuant to Section 5.9(c) of this Ordinance, and provided further that in no event shall Net Revenues ever be less than the amount required to establish and maintain the First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund as hereinafter provided, to establish and maintain the Second Lien Bond Interest and Sinking Fund and the Second Lien Bond Reserve Fund as hereinafter provided and, to the extent that funds for such purpose are not otherwise available, to pay all other Outstanding Obligations payable from the Net Revenues of the System, including all amounts owed as a repayment obligation by the City pursuant to a Reserve Fund Surety Policy or a Credit Agreement, as and when the same become due.

Effective for monthly billing cycles for the System commencing on April 1, 2005 and on April 1 of each year thereafter and subject to the terms of existing contracts, the requirements of the immediately preceding paragraph of this Section 5.2, applicable Texas law and the authority of the City Council of the City to adopt other rates and charges, rates and charges for the use and services of the System shall be adjusted based on the percentage change (if any) in the Designated Index or other appropriate index for the preceding calendar year. The calculation required by this Section 5.2 shall be made annually at the time City's Annual Budget for the System is adopted and shall be included in the Annual Budget for the System.

Section 5.3. Special Funds.

The following special Funds shall be established, maintained and accounted for on the books of the City as hereinafter provided so long as any of the Bonds or other Obligations remain Outstanding:

(a) Revenue Fund;

(b) First Lien Bond Interest and Sinking Fund;

(c) First Lien Bond Reserve Fund;

(d) Second Lien Bond Interest and Sinking Fund;

(e) Second Lien Bond Reserve Fund;

(f) Third Lien Obligation Interest and Sinking Fund;

(g) Third Lien Obligation Reserve Fund (if and when required);

(h) Fourth Lien Obligation Interest and Sinking Fund (if and when required);

(i) Fourth Lien Obligation Reserve Fund (if and when required);

(j) Interest and Sinking Funds and Reserve Funds for any additional Obligations that will be junior and subordinate to Fourth Lien Obligations (if and when required); and

(k) CUS General Purpose Fund.

All of such Funds shall be maintained as separate accounts on the books of the City. The First Lien Bond Interest and Sinking Fund and the First Lien Bond Reserve Fund shall constitute trust funds which shall be held in trust for the Owners of the First Lien Bonds (and parity Obligations, if any, under Qualified Hedge Agreements and Credit Agreements) and the proceeds of which (except for interest income, which shall be transferred to the Revenue

Fund) shall be pledged to the payment of the First Lien Bonds and such parity Obligations. The Second Lien Bond Interest and Sinking Fund and the Second Lien Bond Reserve Fund shall constitute trust funds which shall be held in trust for the benefit of the Owners of the Second Lien Bonds (and parity Obligations, if any, under Qualified Hedge Agreements and Credit Agreements) and the proceeds of which (except for interest income, which shall be transferred to the Revenue Fund) shall be and are hereby pledged to the payment of the Second Lien Bonds and such parity Obligations. All of the Funds named above shall be used solely as herein provided so long as any First Lien Bonds or Second Lien Bonds or such parity Obligations remain Outstanding. The City reserves the right to establish, maintain, and account for on the books of the City such additional funds and accounts as may be necessary or desirable in the efficient administration of the System and flow of funds governing all Outstanding Obligations.

Section 5.4. Flow of Funds.

After making any Required Payments in accordance with the terms of the Previous Ordinance, Gross Revenues of the System shall be deposited as collected into the Revenue Fund and shall be applied (i) to pay Maintenance and Operation Expenses, to the extent not already paid, and (ii) to establish and maintain an operating reserve equal to two month's budgeted Maintenance and Operation Expenses. The remaining balance, together with Restricted Receipts, shall be applied in the following manner and in the following order of priority:

(a) First, to make all deposits into the First Lien Bond Interest and Sinking Fund required by Section 5.5 hereof or any Supplemental Ordinance authorizing the issuance of First Lien Bonds;

(b) Second, to make all deposits into the First Lien Bond Reserve Fund required by Section 5.6 hereof or any Supplemental Ordinance authorizing the issuance of First Lien Bonds;

(c) Third, to make all deposits into the Second Lien Bond Interest and Sinking Fund required by Section 5.7 hereof or any Supplemental Ordinance authorizing the issuance of Second Lien Bonds;

(d) Fourth, to make all deposits into the Second Lien Bond Reserve Fund required by Section 5.8 hereof or any Supplemental Ordinance authorizing the issuance of Second Lien Bonds;

(e) Fifth, to make all payments and deliveries, as may be required by any Supplemental Ordinance of the City authorizing the issuance of certain Third Lien Obligations authorized by Section 6.3 hereof, in order to provide for the payment of and security for such Third Lien Obligations;

(f) Sixth, to make all payments and deliveries, as may be required by any Supplemental Ordinance of the City authorizing the issuance of certain Fourth Lien Obligations described in Section 6.3 hereof, in order to provide for the payment of and security for such Fourth Lien Obligations; and

(g) Seventh, to deposit any remaining Net Revenues into the CUS General Purpose Fund.

Section 5.5. First Lien Bond Interest and Sinking Fund.

On or before the last Business Day immediately preceding (i) an Interest Payment Date so long as any First Lien Bonds remain Outstanding, and (ii) any date when any payments are due and payable under a Qualified Hedge Agreement relating to First Lien Bonds, there shall be transferred into the First Lien Bond Interest and Sinking Fund from the Revenue Fund the following amounts:

(a) Such amounts as will be sufficient to pay the amount of interest scheduled to become due on the First Lien Bonds on such Interest Payment Date; plus

(b) Such amounts, if any, as will be sufficient to pay the amount of principal of the First Lien Bonds due on such Interest Payment Date, including the principal amounts of, and any redemption premiums on, any First Lien Bonds payable as a result of the operation or exercise of any mandatory or optional redemption provision contained in any Supplemental Ordinance authorizing the issuance of First Lien Bonds; plus

(c) Such amounts, if any, as shall be necessary to pay fees, charges, and other amounts payable to any and all of the Paying Agent/Registrar, and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider, or Qualified Hedge Agreement provider which, by the terms of their agreements with the City, are payable from the First Lien Bond Interest and Sinking Fund.

Moneys credited to the First Lien Bond Interest and Sinking Fund shall be used solely for the purpose of paying interest on, principal (at maturity or prior redemption or to purchase First Lien Bonds issued as term bonds in the open market to be credited against mandatory redemption requirements) of and redemption premiums on the First Lien Bonds, plus all fees, charges, and other amounts payable to any and all of the Paying Agent/Registrar, and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider, or Qualified Hedge Agreement provider which, by the terms of their agreements with the City, are payable from the First Lien Bond Interest and Sinking Fund. On or before each date principal becomes due and/or Interest Payment Date on the First Lien Bonds, the City shall transfer from the First Lien Bond Interest and Sinking Fund to the Paying Agent/Registrar in immediately available funds an amount equal to the principal and interest payable on the First Lien Bonds on such date.

Section 5.6. First Lien Bond Reserve Fund.

On or before the last Business Day of each month so long as any First Lien Bonds that are Reserve Fund Participants remain Outstanding, there shall be transferred into the First Lien Bond Reserve Fund from the Revenue Fund amounts equal to one-sixtieth (1/60th) of the Reserve Fund Requirements for the First Lien Bonds unless or until there has been accumulated in the First Lien Bond Reserve Fund money and investments in an aggregate amount at least equal to the Reserve Fund Requirements for the First Lien Bonds; provided that additional deposits into the First Lien Bond Reserve Fund sufficient to provide for the increased Reserve Fund Requirement resulting from the issuance of any Additional First Lien Bonds that are Reserve Fund Participants shall be made by not later than 60 months from the date of issuance of such Additional First Lien Bonds. After such amount has accumulated in the First Lien Bond Reserve Fund and so long thereafter as such Fund contains such amount, no further deposits shall be required to be made into the First Lien Bond Reserve Fund, and any excess amounts in such Fund may be transferred to the Revenue Fund. But if and whenever the balance in the First Lien Bond Reserve Fund is reduced below such amount, monthly deposits into such Fund shall be resumed and continued in amounts at least equal to one-sixtieth (l/60th) of the Reserve Fund Requirements on the First Lien Bonds until the First Lien Bond Reserve Fund has been restored to such amount. The First Lien Bond Reserve Fund shall be used to pay the principal of and interest on the First Lien Bonds that are Reserve Fund Participants (and parity Obligations, if any, under Qualified Hedge Agreements and Credit Agreements) at any time when there is not sufficient money available in the First Lien Bond Interest and Sinking Fund for such purpose and it may be used finally to pay and retire the last First Lien Bonds that are Reserve Fund Participants to mature or be redeemed.

The requirements of the immediately preceding paragraph of this Section notwithstanding, the City may provide a Reserve Fund Surety Policy issued in amounts equal to all or part of the Reserve Fund Requirements on the First Lien Bonds that are Reserve Fund Participants in lieu of depositing cash into the First Lien Bond Reserve Fund. In the event a Reserve Fund Surety Policy issued to satisfy all or a part of the City's obligation with respect to the First Lien Bond Reserve Fund causes the amount then on deposit in the First Lien Bond Reserve Fund to exceed the Reserve Fund Requirements on all First Lien Bonds, the City may transfer such excess amount to any fund or funds established for the payment of or security for First Lien Bonds, the Second Lien Bonds, or any Third Lien Obligations or Fourth Lien Obligations (including any escrow established for the final payment of any such Obligations preceding an Interest Payment Date pursuant to Chapter 1207, Texas Government Code), or to the CUS General Purpose Fund.

Section 5.7. Second Lien Bond Interest and Sinking Fund.

On or before the last business day immediately preceding (i) an Interest Payment Date, so long as any Second Lien Bonds remain Outstanding, and (ii) on any date when any payment is due and payable under a Qualified Hedge Agreement relating to Second Lien Bonds, there shall be transferred into the Second Lien Bond Interest and Sinking Fund from the Revenue Fund the following amounts:

(a) such amounts as will be sufficient to pay the amount required to pay the amount of interest scheduled to become due on the Second Lien Bonds on such Interest Payment Date; plus

(b) such amounts, if any, as will be sufficient to pay the amount of the next maturing principal of the Second Lien Bonds due on such Interest Payment Date, including the principal amounts of, and any redemption premiums on, any Second Lien Bonds payable as a result of the operation or exercise of any mandatory or optional redemption provision contained in any Supplemental Ordinance authorizing the issuance of Additional Second Lien Bonds; plus

(c) such amounts, if any, shall be necessary to pay fees, charges, and other amounts payable to any and all of the Paying Agent/Registrar, and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider, or Qualified Hedge Agreement provider which, by the terms of their agreements with the City, are payable from the Second Lien Bond Interest and Sinking Fund.

Moneys credited to the Second Lien Bond Interest and Sinking Fund shall be used solely for the purpose of paying interest on, principal (at maturity or prior redemption or to purchase Second Lien Bonds issued as term bonds in the open market to be credited against mandatory redemption requirements) of and redemption premiums on the Second Lien Bonds, plus all fees, charges, and other amounts payable to any and all of the Paying Agent/Registrar, and any auction agent, market agent, broker/dealer, remarketing agent, Credit Agreement provider, or Qualified Hedge Agreement provider which, by the terms of their agreements with the City, are payable from the Second Lien Bond Interest and Sinking Fund. On or before each principal becomes due and/or Interest Payment Date on the Second Lien Bonds, the City shall transfer from the Second Lien Bond Interest and Sinking Fund to the Paying Agent/Registrar in immediately available funds an amount equal to the principal and interest payable on the Second Lien Bonds on such date.

The Paying Agent/Registrar shall totally destroy all paid Second Lien Bonds and shall provide the City with an appropriate certificate of destruction.

Section 5.8. Second Lien Bond Reserve Fund.

On or before the last Business Day of each month so long as any Second Lien Bonds that are Reserve Fund Participants remain Outstanding, there shall be transferred into the Second Lien Bond Reserve Fund from the Revenue Fund amounts equal to at least one-sixtieth (1/60th) of the Reserve Fund Requirements for the Second Lien Bonds unless or until there has been accumulated in the Second Lien Bond Reserve Fund money and investments in an aggregate amount at least equal to the Reserve Fund Requirements for the Second Lien Bonds; provided that additional deposits into the Second Lien Bond Reserve Fund sufficient to provide for the increased Reserve Fund Requirements resulting from the issuance of any Additional Second Lien Bonds that are Reserve Fund Participants shall be made by not later than 60 months from the date of issuance of such Additional Second Lien Bonds. After such amount has accumulated in the Second Lien Bond Reserve Fund and so long thereafter as such Fund contains such amount, no further deposits shall be required to be made into the Second Lien Bond Reserve Fund, and any excess amounts in the Fund may be transferred to the Revenue Fund. But if and whenever the balance in the Second Lien Bond Reserve Fund is reduced below such amount, monthly deposits into such Fund shall be resumed and continued in amounts at least equal to one-sixtieth (1/60th) of the Reserve Fund Requirements on the Second Lien Bonds until the Second Lien Bond Reserve Fund has been restored to such amount. The Second Lien Bond Reserve Fund shall be used to pay the principal of and interest on the Second Lien Bonds that are Reserve Fund Participants (and parity Obligations, if any, under Qualified Hedge Agreements and Credit Agreements) at any time when there is not sufficient money available in the Second Lien Bond Interest and Sinking Fund for such purpose and it may be used finally to pay and retire the last Second Lien Bonds that are Reserve Fund Participants to mature or be redeemed.

The requirements of the immediately preceding paragraph of this Section notwithstanding, the City may provide a Reserve Fund Surety Policy issued in amounts equal to all or part of the Reserve Fund Requirements on the Second Lien Bonds that are Reserve Fund Participants in lieu of depositing cash into the Second Lien Bond Reserve Fund. In the event a Reserve Fund Surety Policy issued to satisfy all or a part of the City's obligation with respect to the Second Lien Bond Reserve Fund causes the amount then on deposit in the Second Lien Bond Reserve Fund to exceed the Reserve Fund Requirements on all Second Lien Bonds, the City may transfer such excess

amount to any fund established for the payment of or security for First Lien Bonds, the Second Lien Bonds, or any Third Lien Obligations or Fourth Lien Obligations (including any escrow established for the final payment of any such obligations pursuant to Chapter 1207, Texas Government Code), or to the CUS General Purpose Fund.

Section 5.9. CUS General Purpose Fund.

Subject to the payment to the provider of a Reserve Fund Surety Policy of any interest on amounts advanced and any expenses incurred under the Reserve Fund Surety Policy required to be paid pursuant to an agreement between the City and the provider of such Reserve Fund Surety Policy, and subject to the provisions of Sections 5.5, 5.6, 5.7, and 5.8 hereinabove in this Article, from any moneys remaining in the Revenue Fund, at least annually within 90 days following the end of each Fiscal Year, there shall be set aside and credited to the CUS General Purpose Fund, the remaining revenues in the Revenue Fund. Moneys accounted for in the CUS General Purpose Fund, subject to any limitations herein or in any other contract pertaining to such account, may be withdrawn in any priority for any one, all, or any combination of the following:

(a) Capital Costs. To pay the costs of constructing or otherwise acquiring any betterments of, enlargement of, extensions of, or any other improvements to the System, or any part thereof, and any equipment therefor, authorized by law;

(b) Major Maintenance Costs. To pay the costs of extraordinary and major repairs, renewals, replacements, or maintenance items pertaining to any properties of the System of a type not recurring annually or at shorter intervals and not paid as Maintenance and Operation Expenses;

(c) Debt Service Requirements. To pay any Bonds or other Obligations or securities pertaining to the System and payable from Net Revenues (regardless of whether such securities are secured by a lien thereon), as to Debt Service Requirements and any other appurtenant charge pertaining to such Debt Service Requirements on any Interest Payment Date, or any redemption date or redemption dates, or by purchase in the open market, or by creating an escrow to provide for the payment of or to defease such Bonds, other Obligations or securities or otherwise;

(d) Legal Obligations. To pay any obligations pertaining to the System and arising from a judgment against the City or any officer, employee, or other agent of the City acting within the scope of his official duties, rights, or privileges, or the scope of his employment, as the case may be, in any suit, action, or special proceedings in equity or at law, in any court of competent jurisdiction, or a settlement by the City of any claim to avoid or to settle such a suit, action, or special proceedings, except to the extent revenues are otherwise available to defray such an obligation, including, without limitation, insurance proceeds, or to pay any penalties, fines, settlements or other amounts required to be paid by the City as a result of federal or state administrative proceedings relating to the System;

(e) Assumed and Other Obligations. To pay any bonds or other obligations assumed by the City which were issued or incurred by water districts annexed and dissolved by the City, which bonds or other obligations are by their own terms secured in whole or in part by a pledge of water or sewer revenues which did not terminate upon the annexation and dissolution of such water districts, and other bonds or obligations issued or assumed by the City for combined utility system purposes which are payable from ad valorem taxes or sources other than the First Lien Bond Interest and Sinking Fund, the First Lien Bond Reserve Fund, the Second Lien Bond Interest and Sinking Fund, or the Second Lien Bond Reserve Fund;

(f) Lawful System Purposes. For any other lawful purpose of the System as the City may determine; and

(g) Drainage Purposes. For planning, design, construction, regulation, improvement, repair, maintenance, and operation of facilities and programs relating to the system or network of storm water management facilities including, but not limited to, inlets, conduits, manholes, channels, ditches, drainage easements, retention and detention basin, infiltration facilities, and other components, including, without limitation, the costs of developing, implementing, and enforcing a storm water management program to reduce the discharge of pollutants from the City's storm sewer system and protect water quality, and the costs related to obtaining, renewing, or maintaining any required permits related to the operation of the

storm sewer system, and also including payment of debt service on bonds, notes, or other obligations issued for the purposes listed in this paragraph (g); provided that the aggregate amount withdrawn from the CUS General Purpose Fund pursuant to this paragraph (g) during any Fiscal Year shall not exceed 8% of the Gross Revenues of the System for the immediately preceding Fiscal Year.

Section 5.10. Application of CUS General Purpose Fund.

Moneys shall be withdrawn from the CUS General Purpose Fund for any one, all, or other combination of such purposes designated in Section 5.9 hereof in the same manner that other claims against the System are presented and paid. Amounts in the CUS General Purpose Fund at the beginning of a Fiscal Year which are deposited into the Revenue Fund in that Fiscal Year are Gross Revenues for the Fiscal Year in which such amounts are deposited into the Revenue Fund.

Section 5.11. Investment of Funds; Transfer of Investment Income.

(a) Money in the Revenue Fund, the First Lien Bond Interest and Sinking Fund, the First Lien Bond Reserve Fund, the Second Lien Bond Interest and Sinking Fund, the Second Lien Bond Reserve Fund, and the CUS General Purpose Fund may, at the option of the City, be invested in investments as permitted by state law, consistent with the City's investment policy; provided that all such deposits and investments shall be made in such manner that the money required to be expended from any Fund will be available at the proper time or times, and provided further that in no event shall such deposits or investments of moneys in the First Lien Bond Reserve Fund or the Second Lien Bond Reserve Fund mature later than the final maturity date of the First Lien Bonds or the Second Lien Bonds, as the case may be. All such investments shall be valued in terms of current market value no less frequently than the last Business Day of the City's Fiscal Year, except that any direct obligations of the United States of America - State and Local Government Series may be continuously valued at their par value or principal face amount. Any obligation in which money is so invested shall be kept and held in an official depository of the City, except as hereinafter provided. For purposes of maximizing investment returns, money in such funds may be invested, together with money in other funds or with other money of the City, in common investments of the kind described above, or in a common pool of such investments which shall be kept and held at an official depository of the City, which shall not be deemed to be or constitute a commingling of such money or funds provided that safekeeping receipts or certificates of participation clearly evidencing the investment or investment pool in which such money is invested and the share thereof purchased with such money or owned by such fund are held by or on behalf of each such fund. If necessary, such investments shall be promptly sold to prevent any default.

(b) All interest and income derived from such deposits and investments shall be credited to the Revenue Fund monthly, and shall constitute Gross Revenues of the System.

Section 5.12. Security for Uninvested Funds.

So long as any Bonds remain Outstanding, all uninvested moneys on deposit in, or credited to, the Revenue Fund, the First Lien Bond Interest and Sinking Fund, the First Lien Bond Reserve Fund, the Second Lien Bond Interest and Sinking Fund, the Second Lien Bond Reserve Fund, and the CUS General Purpose Fund shall be secured by the pledge of security as provided by law for cities in the State of Texas.

Section 5.13. Reservation of Right to Issue Board Bonds on a Parity with Previous Ordinance Bonds.

The City reserves the right to issue Board Bonds at any time and from time to time to the Texas Water Development Board on a parity with the Previous Ordinance Bonds, anything in this Ordinance or any Supplemental Ordinance to the contrary notwithstanding. Except for the right to issue the Board Bonds, the City hereby covenants and agrees not to issue any bonds or other obligations under the terms of the Previous Ordinance.

ARTICLE VI

ADDITIONAL BONDS AND OTHER OBLIGATIONS

Section 6.1. Additional First Lien Bonds and Additional Second Lien Bonds.

The City reserves the right to issue, for any lawful System purpose, including the refunding of any previously issued First Lien Bonds, Second Lien Bonds, Previous Ordinance Bonds, or any other bonds or obligations of the City issued in connection with the System or payable from Net Revenues, or to pay obligations incurred under or pursuant to any Credit Agreement or Qualified Hedge Agreement, one or more series of (i) Additional First Lien Bonds on a parity with the Outstanding First Lien Bonds payable from, and secured by a first lien on, the Net Revenues of the System senior and superior to the lien securing the Second Lien Bonds; and (ii) Additional Second Lien Bonds on a parity with the Outstanding Second Lien Bonds; provided, however, that no Additional First Lien Bonds or Additional Second Lien Bonds may be issued unless:

(a) The First Lien Bond Reserve Fund (and, for the issuance of Additional Second Lien Bonds, the Second Lien Bond Reserve Fund) each contains the amount of money then required to be on deposit therein;

(b) For either the preceding Fiscal Year or any consecutive 12-month period out of the 18-month period immediately preceding the month in which the Supplemental Ordinance authorizing such Additional First Lien Bonds or Additional Second Lien Bonds, as the case may be, is adopted (the "Base Period") either:

(1) Net Revenues are certified by the City Controller of the City to have been equal to not less than the greater of (A) 120% of the combined Maximum Annual Debt Service Requirements on all First Lien Bonds and any Previous Ordinance Bonds or (B) 110% of the combined Maximum Annual Debt Service Requirements on all First Lien Bonds, Second Lien Bonds, and any Previous Ordinance Bonds, after giving effect to the issuance of the Additional First Lien Bonds or Additional Second Lien Bonds to be issued; or

(2) Net Revenues, adjusted to give effect to any rate increase, new customers, or annexation of territory placed into effect or consummated prior to the adoption of the ordinance authorizing the Additional First Lien Bonds or Additional Second Lien Bonds, as the case may be, to the same extent as if such rate increase, new customers, or annexation had been placed into effect or consummated prior to the commencement of the Base Period, would have been equal to at least the greater of (A) or (B) in paragraph (1) above, as certified by an independent consulting engineer or independent firm of consulting engineers;

provided that all or any portion of the Net Revenues required by clauses (1) and (2) of paragraph (b) above that exceed 100% of the Maximum Annual Debt Service Requirements may be attributed to amounts on deposit in the CUS General Purpose Fund that are available to pay Debt Service Requirements pursuant to Section 5.9(c) of this Ordinance; provided, further, that this requirement shall not apply to the issuance of any series of Additional Second Lien Bonds for the purpose of refunding Outstanding First Lien Bonds, or to the issuance of any series of Additional First Lien Bonds or Additional Second Lien Bonds for refunding purposes, that will not have the result of increasing the Average Annual Debt Service Requirements on the First Lien Bonds or the Second Lien Bonds; and

(c) Provision is made in the Supplemental Ordinance authorizing the Additional First Lien Bonds or Additional Second Lien Bonds then proposed to be issued for (1) additional payments into the First Lien Bond Interest and Sinking Fund or Second Lien Bond Interest and Sinking Fund, as the case may be, sufficient to provide for the payment of the increased principal of and interest on the First Lien Bonds or Second Lien Bonds resulting from the issuance of such Additional First Lien Bonds or Additional Second Lien Bonds, and (2) additional payments into the First Lien Bond

Reserve Fund or Second Lien Bond Reserve Fund, as the case may be, sufficient to provide for the accumulation therein of the increased Reserve Fund Requirements resulting from the issuance of such Additional First Lien Bonds or Additional Second Lien Bonds, by not later than 60 months from the date of issuance of such Additional First Lien Bonds or Additional Second Lien Bonds.

(d) Special Provisions for Refunding Short Term Obligations. The provisions of paragraph (b) above shall not apply to the issuance of Additional First Lien Bonds for the purpose of refunding Short Term Obligations issued as First Lien Bonds or the issuance of Additional Second Lien Bonds for the purpose of refunding Short Term Obligations issued as First Lien Bonds or Second Lien Bonds.

(e) Special Provisions for Credit Agreements. The City may enter into Credit Agreements with respect to any Bonds or Qualified Hedge Agreements if:

(i) prior to entering into such Credit Agreement, the City, to the extent required by law, shall cause the proceedings authorizing the Credit Agreement and any contracts or reimbursement agreements relating thereto to be submitted to and approved by the Attorney General of Texas; and

(ii) for any Credit Agreement that obligates the City to make any future payments for the availability of such Credit Agreement, the City's financial advisor must certify in a written certificate delivered to the City that the inclusion of such payments within the Debt Service Requirements on the Bonds or Qualified Hedge Agreement to which the Credit Agreement relates will not cause such Bonds or Qualified Hedge Agreement to fail to comply with the applicable coverage requirements for their issuance or incurrence; and

The issuer of any Credit Agreement shall be entitled to be subrogated to the rights of the Owners of the Bonds or the counterparty to the Qualified Hedge Agreement secured by such Credit Agreement, and the City's reimbursement and repayment obligations to the issuer of the Credit Agreement shall be secured by Net Revenues as herein provided.

(f) Special Provisions for Qualified Hedge Agreements. The City may enter into Qualified Hedge Agreements in connection with any Bonds for any purpose authorized by law if the following requirements are satisfied:

(i) the proceedings authorizing the Qualified Hedge Agreement and any contracts or reimbursement agreements relating thereto shall, to the extent required by law, be submitted to and approved by the Attorney General of Texas; and

(ii) the City's financial advisor shall certify in a written certificate delivered to the City that the Bonds to which the Qualified Hedge Agreement relates could have been issued in satisfaction of all of the coverage requirements of this Article Six if the Debt Service Requirements with respect to such Bonds are recalculated (as provided in the definition of Debt Service Requirements) to take into account the Qualified Hedge Agreement.

Section 6.2. Short Term Obligations.

The City reserves the right to issue, from time to time, one or more series of Additional First Lien Bonds and/or Additional Second Lien Bonds in accordance with Section 6.1 hereof as Short Term Obligations.

Section 6.3. Third Lien Obligations and Fourth Lien Obligations.

The City reserves the right to issue, for any lawful purpose, Third Lien Obligations secured in whole or in part by liens on the Net Revenues that are junior and subordinate to the liens on Net Revenues securing payment of the First Lien Bonds and the Second Lien Bonds. The City also reserves the right to issue Fourth Lien Obligations secured in whole or in part by liens on Net Revenues that are junior and subordinate to the liens on Net Revenues securing payment of First Lien Bonds, Second Lien Bonds, and Third Lien Obligations.

Section 6.4. Supplemental Ordinance.

Bonds payable from Net Revenues shall be issued only after authorization thereof by a Supplemental Ordinance stating the purpose or purposes of the issuance of such additional Bonds, directing the application of the proceeds thereof to such purpose or purposes, directing the execution and authentication thereof, and fixing and determining the date, principal amount, maturity or maturities, designation, and numbers thereof, the maximum rate or the rate or rates of interest to be borne thereby, any prior redemption privileges of the City with respect thereto, and other provisions thereof. Upon such authorization such additional Bonds may at one time or from time to time be executed by and on behalf of the City and authenticated and delivered by the City or upon its order. All additional Bonds shall bear such date, shall bear such numbers and series designation, letters, or symbols prefixed to their numbers distinguishing them from each other security, shall be payable at such place or places, may be subject to redemption prior to maturity on such terms and conditions, and shall bear interest at such rate or at such different or varying rates per annum, as may be fixed by ordinance or other document of the City. Third Lien Obligations, Fourth Lien Obligations, Qualified Hedge Agreements, and Credit Agreements shall be issued pursuant to Supplemental Ordinances or pursuant to separate ordinances that shall provide for the timing of transfer from the Revenue Fund to the debt service funds and reserve funds, if any, established for such Obligations consistent with the order of priority set forth in Section 5.4 hereof.

Section 6.5. Special Project Obligations.

The City reserves the right to issue other obligations secured by liens on and pledges of revenues and proceeds derived from Special Projects.

ARTICLE VII

COVENANTS AND PROVISIONS RELATING TO BONDS AND OTHER OBLIGATIONS

Section 7.1. Punctual Payment of Bonds and Other Obligations.

The City covenants that it will punctually pay or cause to be paid the interest on and principal of all Bonds and other Obligations according to the terms thereof and will faithfully do and perform, and at all times fully observe, any and all covenants, undertakings, stipulations and provisions contained in this Ordinance and in any Supplemental Ordinance authorizing the issuance of such Bonds and other Obligations.

Section 7.2. Power to Own and Operate System; Ratemaking Power.

The City covenants that it currently owns the System and has all necessary power and authority to own and operate the System as herein described and provided and that it possesses, and shall exercise, all necessary power and authority to establish, fix, increase, impose and collect rates and charges for the use and services of the System in the amounts required to comply with the covenants and provisions contained herein.

Section 7.3. Maintenance of System.

So long as any Bonds or other Obligations remain Outstanding, the City covenants that it will at all times maintain the System, or within the limits of its authority cause the same to be maintained, in good condition and working order and will operate the same, or cause the same to be operated, in an efficient and economical manner at a reasonable cost and in accordance with sound business principles. In operating and maintaining the System, the City will comply with all contractual provisions and agreements entered into by it and with all valid rules, regulations, directions or orders of any governmental, administrative or judicial body promulgating same, noncompliance with which would materially and adversely affect the operation of the System.

Section 7.4. Sale or Encumbrance of System.

So long as any Bonds remain Outstanding, the City covenants that it will not sell, dispose of or, except as permitted in Article VI, further encumber the System; provided, however, that this provision shall not prevent the City from disposing of any portion of the System which is being replaced or is deemed by the City to be obsolete,

worn out, surplus or no longer needed for the proper operation of the System. Net proceeds from any such disposition may be deposited in the CUS General Purpose Fund. Any agreement pursuant to which the City contracts with a person, corporation, municipal corporation, political subdivision or other entity to operate the System or to lease and/or operate or to lease and lease back to the City all or part of the System shall not be considered as an encumbrance of the System.

Section 7.5. Insurance.

The City covenants that it will keep the System insured with insurers of good standing against risks, accidents or casualties against which and to the extent customarily insured against by political subdivisions of the State of Texas operating similar properties, to the extent that such insurance is available. All net proceeds of such insurance may be applied to repair or replace the insured property that is damaged or destroyed, or may be deposited in the CUS General Purpose Fund. The cost of all such insurance, together with any additional insurance, shall be a part of the Maintenance and Operation Expenses.

Section 7.6. Accounts, Records, and Audits.

So long as any Bonds or other Obligations remain Outstanding, the City covenants that it will maintain a proper and complete system of records and accounts pertaining to the operation of the System in which full, true and proper entries will be made of all dealings, transactions, business and affairs which in any way affect or pertain to the System or the Gross Revenues or the Net Revenues thereof. The City shall after the close of each Fiscal Year prepare financial statements of the System, and have those financial statements audited by an independent certified public accountant or independent firm of certified public accountants. After the audit, the City shall furnish a copy of these audited financial statements, together with the independent certified public accountant's report thereon, without cost, to the Municipal Advisory Council of Texas, each Rating Agency then rating the Bonds, the Texas Water Development Board, and any Owners of Bonds who shall request the same. All expenses incurred in preparing such audits shall be Maintenance and Operation Expenses.

Section 7.7. Competition.

To the extent it legally may, the City covenants that it will not grant any franchise or permit for the acquisition, construction or operation of any competing facilities which might be used as a substitute for the System and will prohibit the operation of any such competing facilities to the extent that such competing facilities would impair the City's ability to pay principal of or interest on the Bonds or other Obligations.

Section 7.8. Pledge and Encumbrance of Net Revenues.

The City covenants that it has the lawful power to create a lien on and to pledge the Net Revenues to secure the payment of the Obligations, and has lawfully exercised such power under the Constitution and laws of the State of Texas. The City further covenants that, other than to the payment of the Obligations, the Net Revenues are not and will not be made subject to any other lien, pledge or encumbrance to secure the payment of any debt or obligation of the City, unless such lien, pledge or encumbrance is junior and subordinate to the lien and pledge securing payment of the Obligations.

Section 7.9. Covenants with Respect to Certain Assumed Water District Bonds.

So long as any Bonds or other Obligations remain Outstanding, the City covenants as follows:

(a) To the extent it legally may, the City will impose, and strictly enforce, the requirement upon all water districts located within the City's extraterritorial jurisdiction that any bonds or obligations issued or incurred by such water districts which are secured in whole or in part by pledges of or liens on water or sewer revenues shall provide that all such pledges of and liens on water or sewer revenues shall automatically terminate upon the annexation and dissolution of the district by the City;

(b) The City shall use its best efforts to redeem, refund, or defease all annexed water district bonds assumed by the City which by their own terms are secured in whole or in part by pledges of or

liens on water or sewer revenues which do not terminate upon annexation and dissolution by the City of such water district, or otherwise to provide for the discharge of such pledges or liens on water or sewer revenues; and

(c) Pursuant to Section 43.075, Texas Local Government Code, the City shall, unless it has theretofore made adequate provision for the payment thereof, annually levy and cause to be collected taxes upon all taxable property of the City sufficient to pay principal of and interest, as they respectively become due and payable, on all assumed bonds, warrants and other obligations that were issued by water districts that have been annexed to, and dissolved by, the City, and which are by their own terms secured in whole or in part by a lien on or pledge of water or sewer revenues which did not terminate upon the annexation and dissolution by the City of such water district.

Section 7.10. Bondholders Rights and Remedies.

This Ordinance shall constitute a contract between the City and the Owners of the Bonds from time to time Outstanding and this Ordinance shall be and remain irrepealable until the Bonds and the interest thereon shall be fully paid or discharged or provision therefor shall have been made as provided herein. In the event of a default in the payment of the principal of or interest on any of the Bonds or a default in the performance of any duty or covenant provided by law or in this Ordinance, the Owner or Owners of any of the Bonds may pursue all legal remedies afforded by the Constitution and laws of the State of Texas to compel the City to remedy such default and to prevent further default or defaults. Without in any way limiting the generality of the foregoing, it is expressly provided that any Owner of any of the Bonds may at law or in equity, by suit, action, mandamus, or other proceedings, enforce and compel performance of all duties required to be performed by the City under this Ordinance, including the making and collection of reasonable and sufficient rates and charges for the use and services of the System, the deposit of the revenues thereof into the special funds herein provided, and the application of such revenues in the manner required in this Ordinance. A Supplemental Ordinance may provide that, so long as an issuer of a municipal bond insurance policy shall not have defaulted in its payment obligations under such policy with the City insuring a portion of the Bonds, such issuer shall, under the terms of this Ordinance, at all times be deemed to be the exclusive owner of such Bonds for the purpose of all approvals, consents, waivers or institutions of any action and the direction of all remedies.

Section 7.11. Defeasance.

The City may defease the provisions of this Ordinance and discharge its obligation to the Owners of any or all of the Bonds or other Obligations to pay principal, interest and redemption premium, if any, thereon in any manner permitted by law, including by depositing with the Paying Agent/Registrar, or if authorized by Texas law with any national or state bank having trust powers and having combined capital and surplus of at least $50 million or with the Comptroller of Public Accounts of the State of Texas (or any successor office) either: (a) cash in an amount equal to the principal amount and redemption premium, if any, of such Bonds or other Obligations plus interest thereon to the date of maturity or redemption, or (b) pursuant to an escrow or trust agreement, cash and/or securities authorized by § 1207.062 of the Texas Government Code, as amended at the time of issuance of such series of Bonds or Obligations. Such deposits may be invested only in obligations described above that are in principal amounts and maturities and bear interest at rates sufficient to provide for the timely payment of the principal amount and redemption premium, if any, of such Bonds or other Obligations plus interest thereon to the date of maturity or redemption. Upon such deposit and upon receipt of an opinion of nationally recognized bond counsel to the effect that such Bonds or Obligations are deemed to be fully paid and are no longer outstanding, such Bonds or other Obligations shall no longer be regarded to be Outstanding or unpaid. Any surplus amounts not required to accomplish such defeasance shall be returned to the System after the Obligations are retired. Payments of principal of and interest on any Bonds or other Obligations made by a provider of a Credit Agreement insuring a portion of the Bonds or other Obligations shall not be deemed to have been paid hereunder and such Bonds or other Obligations shall continue to be Outstanding until paid by the City.

Section 7.14. Amendment of Ordinance Without Consent.

The City may, without the consent of or notice to any of the Owners, amend this Ordinance and any Supplemental Ordinance for any one or more of the following purposes:

(a) to cure any ambiguity, defect, omission or inconsistent provision in this Ordinance or in the Bonds; or to comply with any applicable provision of law or regulation of federal agencies; provided, however, that such action shall not adversely affect the interests of the Owners of the Bonds;

(b) to grant to or confer upon the Owners of the Bonds any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Owners of the Bonds;

(c) to add to the covenants and agreements of the City contained in this Ordinance other covenants and agreements of, or conditions or restrictions upon, the City or to surrender or eliminate any right or power reserved to or conferred upon the City in this Ordinance;

(d) to subject additional revenues to the lien and pledge of this Ordinance;

(e) to provide for the issuance of Adjustable Rate Obligations, Short Term Obligations, or Refundable Obligations;

(f) to authorize Credit Agreements and Qualified Hedge Agreements with respect to Outstanding Bonds;

(g) to provide for the continued tax exemption for any Outstanding Bonds;

(h) to provide for the continued exemption from registration of any Outstanding Bonds under the federal securities laws; or

(i) to permit other utility systems provided for in Chapter 1502 of the Texas Government Code, as amended, to be combined with the System.

Section 7.15. Amendment to Ordinance Requiring Consent.

The City may, with the consent of Owners holding a majority in aggregate principal amount of the Bonds then Outstanding affected thereby, amend, add to, or rescind any of the provisions of this Ordinance; provided that, without the consent of all Owners of Outstanding Bonds, no such amendment, addition, or rescission shall (1) extend the time or times of payment of the principal of, premium, if any, and interest on the Bonds, or reduce the principal amount thereof, the redemption price therefor, or the rate of interest thereon, (2) give any preference to any Bond over any other Bond, or (3) reduce the aggregate principal amount of Bonds required to be held by Owners for consent to any such amendment, addition, or rescission. For the purposes of this Section 7.15, the Owners of the Bonds shall include the initial Owners regardless of whether such Bonds are being held for subsequent resale.

Section 7.16. No Free Service.

The City will not grant or permit any free service from the System, except for public buildings and institutions operated by the City and properties permitted to be exempt by state law. In addition, the City will not grant or permit any free service from the System permitted by the previous sentence if to do so would violate any condition or covenant to which the City is bound in connection with any federal grant agreement or otherwise.

ARTICLE VIII

MISCELLANEOUS

Section 8.1. Continuing Disclosure Obligations.

The City's continuing disclosure obligations, if any, under United States Securities and Exchange Commission Rule 15c2-12 with respect to Obligations shall be set forth in the Supplemental Ordinance with respect to such Obligations.

APPENDIX E

PROPOSED FORM OF CO-BOND COUNSEL OPINION

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ANDREWS KURTH LLP
600 Travis, Suite 4200
Houston, Texas 77002

BURNEY & FOREMAN
5445 Almeda, Suite 400
Houston, Texas 77004

April 9, 2009

WE HAVE ACTED as Co-Bond Counsel for the CITY OF HOUSTON, TEXAS, a municipal corporation of the State of Texas (the "City") in connection with an issue of bonds (the "Bonds") described as follows:

> CITY OF HOUSTON, TEXAS, COMBINED UTILITY SYSTEM FIRST LIEN REVENUE AND REFUNDING BONDS, SERIES 2009A, in the aggregate principal amount of $476,050,000 maturing on November 15 in each year from 2014 through 2027, inclusive, from 2029 through 2033, inclusive, and in the years 2035, 2036 and 2038. The Bonds are issuable in fully registered form only, in denominations of $5,000 or any integral multiple thereof, bear interest, are subject to redemption prior to maturity and may be transferred and exchanged as set out in the Bonds and in the master ordinance and supplemental ordinance (together, the "Ordinance") adopted by the City Council of the City (the "City Council") authorizing their issuance.

WE HAVE ACTED as Co-Bond Counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Bonds under the Constitution and laws of the State of Texas and with respect to the exclusion of interest on the Bonds from gross income under federal income tax law. In such capacity we have examined the Constitution and laws of the State of Texas; federal income tax law; and a transcript of certain certified proceedings pertaining to the issuance of the notes (the "Refunded Notes") and the bonds (the "Refunded Bonds" and, together with the Refunded Notes, the "Refunded Obligations") that are being refunded with the proceeds of the Bonds, as described in the Ordinance. The transcript contains certified copies of certain proceedings of the City and The Bank of New York Mellon Trust Company, N.A. (the "Refunded Bond Escrow Agent"); the report (the "Report") of Grant Thornton LLP, which verifies the sufficiency of the deposits made with the Refunded Bond Escrow Agent for the refunding of the Refunded Bonds, and the mathematical accuracy of certain computations of the yield on the Bonds and the obligations acquired with the proceeds of the Bonds; certain certifications and representations and other material facts within the knowledge and control of the City, upon which we rely; and certain other customary documents and instruments authorizing and relating to the issuance of the Bonds and the firm banking and financial arrangements for the discharge and final payment of the Refunded Obligations. We have also examined executed Bond No. T-1 of this issue.

WE HAVE NOT BEEN REQUESTED to examine, and have not investigated or verified, any original proceedings, records, data or other material, but have relied upon the transcript of certified proceedings. We have not assumed any responsibility with respect to the financial condition or capabilities of the City or the disclosure thereof in connection with the sale of the Bonds. Our role in connection with the City's Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

BASED ON SUCH EXAMINATION, it is our opinion as follows:

(1) The transcript of certified proceedings evidences complete legal authority for the issuance of the Bonds in full compliance with the Constitution and laws of the State of Texas presently in effect; the Bonds constitute valid and legally binding obligations of the City enforceable in accordance with the terms and conditions thereof, except to the extent that the rights and remedies of the owners of the Bonds may be limited by laws heretofore or hereafter enacted relating to bankruptcy, insolvency, reorganization, or moratorium or other similar laws affecting the rights of creditors of political subdivisions and the exercise of judicial discretion in appropriate cases; and the Bonds have been authorized and delivered in accordance with law;

(2) The Bonds are payable, both as to principal and interest, from and secured by a first lien on the Net Revenues received and collected by the City from the operation and ownership of the System after making all Required Payments pursuant to the Previous Ordinance, all as defined in and provided by the Ordinance; and

(3) The escrow agreement between the City and the Refunded Bond Escrow Agent (the "Refunded Bond Escrow Agreement") has been duly executed and delivered and constitutes a binding and enforceable agreement in accordance with its terms; the establishment of the Escrow Fund pursuant to the Refunded Bond Escrow Agreement and the deposits made therein constitute the making of firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds; in reliance upon the accuracy of the calculations contained in the Report, the Refunded Bonds, having been discharged and paid, are no longer outstanding and the lien on and pledge of ad valorem taxes as set forth in the ordinances authorizing their issuance will be appropriately and legally defeased; the holders of the Refunded Bonds may obtain payment of the principal of, redemption premium, if any, and interest in the Refunded Bonds only out of the funds provided therefor now held in escrow for that purpose by the Refunded Bond Escrow Agent pursuant to the terms of the Refunded Bond Escrow Agreement; and therefore the Refunded Bonds are deemed to be fully paid and no longer outstanding, except for the purpose of being paid from the funds provided therefor in such Refunded Bond Escrow Agreement.

IT IS OUR FURTHER OPINION, also based on our examination as described above, and subject to the restrictions hereinafter described, that interest on the Bonds is excludable from gross income of the owners thereof for federal income tax purposes under existing law and is not subject to the federal alternative minimum tax on individuals or corporations. The opinion set forth in the first sentence of this paragraph is subject to the condition that the City comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, or continue to be, excluded from gross income for federal income tax purposes. The City has covenanted in the Ordinance to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the Bonds in gross income for federal income tax purposes to be retroactive to the date of issuance of the Bonds. The Code and the existing regulations, rulings and court decisions thereunder, upon which the foregoing opinions of Co-Bond Counsel are based, are subject to change, which could prospectively or retroactively result in the inclusion of the interest on the Bonds in gross income of the owners thereof for federal income tax purposes.

EXCEPT AS DESCRIBED ABOVE, we express no opinion as to any federal, state or local tax consequences under present law, or future legislation, resulting from the ownership of, receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations, such as the Bonds, may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who are deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations and individuals otherwise qualified for the earned income tax credit. Prospective purchasers should consult their tax advisors as to the consequences of investing in the Bonds.

OUR OPINIONS ARE BASED ON EXISTING LAW, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

APPENDIX F

CONTINUING DISCLOSURE SCHEDULES

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APPENDIX F

CONTINUING DISCLOSURE SCHEDULES

Schedule 1: Net Revenues of the System and Debt Service Coverage

Schedule 2: Coverage of Maximum Annual Debt Service by Net Revenues

Schedule 3: Employees

Schedule 4: System Budget (Fiscal Year 2009)

Schedule 5: Water Supply - Capacity, Production and Sales

Schedule 6: Ten Largest Treated Water Customers

Schedule 7: Ten Largest Untreated Water Customers

Schedule 8: Ten Largest Sewer Customers

Schedule 9: Rate Adjustments

Schedule 10: Funding of Proposed System Improvements

Schedule 11: Obligations Payable from System Revenues

Schedule 12: Discretionary Debt Service Paid by the System

Schedule 13: Indirect Charges Paid by the System and CUS General Purpose Fund Transfers

Schedule 13A: Indirect Charges Paid by the System

Schedule 13B: CUS General Purpose Fund Transfers-Storm Water Fund

Schedule 14: System Debt Service Schedule

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APPENDIX G

DEPOSITORY TRUST COMPANY

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APPENDIX G

DEPOSITORY TRUST COMPANY

The information in this APPENDIX G concerning DTC and its book-entry system has been obtained from DTC. The City believes such information to be reliable, but the City takes no responsibility for the accuracy or completeness thereof.

Book-Entry-Only System

The City has elected to utilize the Book-Entry-Only System of DTC, as described in this APPENDIX G. The obligation of the City is to timely pay the Paying Agent/Registrar the amount due under the Supplemental Ordinance authorizing the issuance of the Bonds. The responsibilities of DTC, the Direct Participants and the Indirect Participants to the Beneficial Owner of the Bonds are described herein.

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for each maturity of the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for the Bonds, in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts

such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bonds documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

All notices of redemption shall (i) specify the date of redemption for the Bonds, (ii) identify the Bonds to be redeemed and, in the case of a portion of the principal amount to be redeemed, the principal amount thereof to be redeemed, (iii) state the redemption price, (iv) state that the Bonds, or the portion of the principal amount thereof to be redeemed, shall become due and payable on the redemption date specified, and the interest thereon, or on the portion of the principal amount thereof to be redeemed, shall cease to accrue from and after the redemption date, and (v) specify that payment of the redemption price for the Bonds, or the principal amount thereof to be redeemed, shall be made at the designated corporate trust office of the Paying Agent/Registrar only upon presentation and surrender thereof by the registered owner. If a Bond is subject by its terms to redemption and has been called for redemption and notice of redemption thereof has been duly given or waived as provided in the Ordinance, such Bonds (or the principal amount thereof to be redeemed) so called for redemption shall become due and payable, and on the redemption date designated in such notice, interest on said Bonds (or the principal amount thereof to be redeemed) so called for redemption shall become due and payable, and on the redemption date designated in such notice, interest on said Bonds (or principal amount thereof to be redeemed) called for redemption shall cease to accrue and such Bonds shall not be deemed to be Outstanding.

The Paying Agent/Registrar and the City, so long as a Book-Entry-Only System is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Ordinance or other notices with respect to the Bonds only to DTC. Any failure by DTC to advise any DTC participant, or of any DTC participant or indirect participant to notify the beneficial owner, shall not affect the validity of the redemption of the Bonds called for redemption or any other action premised or any such notice. Redemption of portions of the Bonds by the City will reduce the outstanding principal amount of such Bonds held by DTC. In such event, DTC may implement, through its Book-Entry-Only System, a redemption of such Bonds held for the account of DTC participants in accordance with its rules or other agreements with DTC participants and then DTC participants and indirect participants may implement a redemption of such Bonds from the beneficial owners. Any such selection of Bonds to be redeemed will not be governed by the Ordinance and will not be conducted by the City or the Paying Agent/Registrar. Neither the City nor the Paying Agent/Registrar will have any responsibility to DTC participants, indirect participants or the persons for whom DTC participants act as nominees, with respect to the payments on the Bonds or the providing of notice to DTC participants, indirect participants, or beneficial owners of the selection of portions of the Bonds for redemption (see "BOOK-ENTRY-ONLY SYSTEM" herein).

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the City or the Paying Agent/Registrar. Under such circumstances, in the event that a successor depository is not obtained, Bonds certificates are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered.

Information concerning DTC and the Book-Entry-Only System has been obtained from DTC and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by the City, the Financial Advisor or the Underwriters.

Use of Certain Terms in Other Sections of this Official Statement. In reading this Official Statement it should be understood that while the Bonds are in the Book-Entry-Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) except as described above, notices that are to be given to registered owners under the Ordinance will be given only to DTC.

Effect of Termination of Book-entry-only System. In the event that the Book-Entry-Only System is discontinued by DTC or the use of the Book-Entry-Only System is discontinued by the City, printed securities certificates will be issued to the respective holders and the Bonds will be subject to transfer, exchange and registration provisions as set forth in the Ordinance and summarized under caption

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APPENDIX H

DESCRIPTION OF RESERVE FUND SURETY POLICIES

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APPENDIX H

DESCRIPTION OF RESERVE FUND SURETY POLICIES

The following information has been obtained from the applicable surety provider for use in this Official Statement. The City, the Co-Financial Advisors and the Underwriters do not make any representations as to the completeness or accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

Series 2004 Bond Reserve Fund Policy

In order to satisfy the Reserve Fund Requirement for the Series 2004 Bonds the City obtained from MBIA Insurance Corporation (the "MBIA") a surety bond (the "MBIA Reserve Fund Surety Policy"). The MBIA Reserve Fund Surety Policy provides that upon notice from the Paying Agent to MBIA to the effect that insufficient amounts are on deposit in the First Lien Bond Interest and Sinking Fund to pay the principal of (at maturity or pursuant to mandatory redemption requirements) and interest on the Series 2004 Bonds, MBIA will promptly deposit with the Paying Agent an amount sufficient to pay the principal of and interest on the Series 2004 Bonds or the available amount of the MBIA Reserve Fund Surety Policy, whichever is less. Upon the later of: (i) three (3) days after receipt by MBIA of a Demand for Payment in the form attached to the MBIA Reserve Fund Surety Policy, duly executed by the Paying Agent; or (ii) the payment date of the Series 2004 Bonds as specified in the Demand for Payment presented by the Paying Agent to MBIA, MBIA will make a deposit of funds in an account with U.S. Bank National Association, in New York, New York, or its successor, sufficient for the payment to the Paying Agent, of amounts which are then due to the Paying Agent (as specified in the Demand for Payment) subject to the coverage of the MBIA Reserve Fund Surety Policy.

The available amount of the MBIA Reserve Fund Surety Policy is the initial face amount of the MBIA Reserve Fund Surety Policy less the amount of any previous deposits by MBIA with the Paying Agent which have not been reimbursed by the City. The City and MBIA have entered into a Financial Guaranty Agreement dated as of May 15, 2004 (the "MBIA Financial Guaranty Agreement"). Pursuant to the MBIA Financial Guaranty Agreement, the City is required to reimburse MBIA, within one year of any deposit, the amount of such deposit made by MBIA with the Paying Agent under the MBIA Reserve Fund Surety Policy. Such reimbursement shall be made only after all required deposits to pay Maintenance and Operation Expenses and required deposits into the First Lien Bond Interest and Sinking Fund and other Master Ordinance required deposits have been made.

Under the terms of the MBIA Financial Guaranty Agreement, the Paying Agent is required to reimburse MBIA, with interest, until the face amount of the MBIA Reserve Fund Surety Policy is reinstated before any deposit is made to the CUS General Purpose Fund. No optional redemption of Series 2004 Bonds may be made until the MBIA Reserve Fund Surety Policy is reinstated. The MBIA Reserve Fund Surety Policy will be held by the Paying Agent in the First Lien Bond Interest and Sinking Fund and is provided as an alternative to the City depositing funds equal to the Debt Service Requirement for outstanding Series 2004 Bonds. The MBIA Reserve Fund Surety Policy was issued in the face amount equal to one-half of the aggregate maximum annual Debt Service Requirements on the Series 2004 Bonds and the premium therefor was fully paid by the City at the time of delivery of the Series 2004 Bonds.

Series 2005 and Series 2007 Bond Reserve Fund Policies

In connection with the issuance of the Series 2005 Bonds and the Series 2007A Bonds, the City obtained separate Reserve Fund Surety Policies from Financial Security for the purpose of funding a portion of the shared First Lien Bond Reserve Fund. Such Reserve Fund Policies will not protect investors against changes in the market value of the Series 2005 Bonds or the Series 2007 Bonds, as applicable, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the Series 2005 Bonds, the Series 2007 Bonds or the advisability of investing in the Series 2005 Bonds or the Series 2007 Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation of the Official Statement.

Financial Security is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A. ("Dexia"), a publicly held Belgian corporation, and of Dexia Credit Local S.A., a direct wholly-owned

subsidiary of Dexia. Dexia, through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or Financial Security is liable for the obligations of Financial Security.

In November 2008, an affiliate of Dexia, the parent of Holdings, entered into a purchase agreement providing for the sale of Holdings to Assured Guaranty Ltd. ("Assured"), subject to the satisfaction of specified closing conditions, including regulatory approvals, absence of rating impairment and segregation or separation of Holdings' financial products operations (the "FP Business") from Holdings' financial guaranty operations. Pursuant to such agreement, the FP Business is expected to be separated from Holdings' financial guaranty operations and retained by Dexia. No assurance can be given that the acquisition of Holdings by Assured will be consummated.

As of December 31, 2008, the FP Business had guaranteed investment contracts and other investment agreements ("GICs") outstanding with a principal amount of $15.248 billion that provide for repayment in the event of a downgrade of Financial Security's financial strength ratings beyond certain thresholds absent collateralization of the GIC obligations. Bank affiliates of Dexia have entered into agreements intended to assume the credit and liquidity risk of the FP Business, including $8 billion of liquidity facilities for the FP Business intended to address the GIC repayment and collateralization consequences of a downgrade of Financial Security. Dexia has announced its intention to obtain Belgium and French government guaranties to backstop Dexia's support obligations with respect to the FP Business, and, according to Dexia, the European Commission has approved the issuance of such guaranties. No assurance can be given that the Belgium and French government guaranties will be issued. Absent those guaranties, Financial Security has significant exposure to Dexia in addressing the current and potential liquidity requirements of the FP Business. Any failure by Dexia to support the FP Business could have a material adverse effect on Financial Security.

At December 31, 2008, Financial Security's consolidated policyholders' surplus and contingency reserves were approximately $1,992,383,920 and its total net unearned premium reserve was approximately $2,520,098,950 in accordance with statutory accounting principles. At December 31, 2008, Financial Security's consolidated shareholder's equity was approximately $2,250,990,129 and its total net unearned premium reserve was approximately $2,040,928,581 in accordance with accounting principles generally accepted in the United States of America.

Portions of the following documents filed by Holdings with the Securities and Exchange Commission ("SEC") that relate to Financial Security are incorporated by reference into this Official Statement and shall be deemed to be a part hereof:

(i) Annual Report of Holdings on Form 10-K for the year ended December 31, 2008.

All information relating to Financial Security included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 after the filing of the last document referred to above and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement and to be a part hereof from the respective dates of filing such documents. Copies of materials incorporated by reference are available over the internet at the SEC's website at http://www.sec.gov or at Holding's website at http://www.fsa.com or will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

Any information regarding Financial Security included herein under the captions "BOND INSURANCE – The Insurer" and " – Recent Events Regarding Financial Security's Ratings" (below) or included in a document incorporated by reference herein (collectively, the "Financial Security Information") shall be modified or superseded to the extent that any subsequently included Financial Security Information (either directly or through incorporation by reference) modifies or supersedes such previously included Financial Security Information. Any Financial Security Information so modified or superseded shall not constitute a part of this Official Statement, except as so modified or superseded.

The Policy does not protect investors against changes in market value of the Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. Financial Security makes no representation regarding the Bonds or the advisability of investing in the Bonds. Financial Security makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that Financial Security has provided to the Issuer the information presented under this caption for inclusion in the Official Statement.

Recent Events Regarding Financial Security's Ratings

On November 21, 2008, Moody's Investors Service, Inc. downgraded to "Aa3" (with developing outlook) from "Aaa" the insurance financial strength rating of Financial Security.

On October 8, 2008, Standard & Poor's Ratings Services placed Financial Security's "AAA" financial strength rating on Credit Watch with negative implications.

On October 9, 2008, Fitch Ratings placed Financial Security's "AAA" insurer financial strength rating on Rating Watch Negative.

These ratings reflect only the views of the respective rating agencies, are not recommendations to buy, sell or hold securities and are subject to revision or withdrawal at any time by those rating agencies.

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APPENDIX I

SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY

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ASSURED GUARANTY®
ENDURING FINANCIAL STRENGTH℠

Financial Guaranty Insurance Policy

Issuer: **Policy No.:**

Obligations: **Premium:**

Effective Date:

Assured Guaranty Corp., a Maryland corporation ("**Assured Guaranty**"), in consideration of the payment of the Premium and on the terms and subject to the conditions of this Policy (which includes each endorsement hereto), hereby unconditionally and irrevocably agrees to pay to the trustee (the "**Trustee**") or the paying agent (the "**Paying Agent**") for the Obligations (as set forth in the documentation providing for the issuance of and securing the Obligations) for the benefit of the Holders, that portion of the Insured Payments which shall become Due for Payment but shall be unpaid by reason of Nonpayment.

Assured Guaranty will make such Insured Payments to the Trustee or the Paying Agent on the later to occur of (i) the date applicable principal or interest becomes Due for Payment, or (ii) the Business Day next following the day on which Assured Guaranty shall have Received a completed Notice of Nonpayment. If a Notice of Nonpayment by Assured Guaranty is incomplete or does not in any instance conform to the terms and conditions of this Policy, it shall be deemed not Received, and Assured Guaranty shall promptly give notice to the Trustee or the Paying Agent. Upon receipt of such notice, the Trustee or the Paying Agent may submit an amended Notice of Nonpayment. The Trustee or the Paying Agent will disburse the Insured Payments to the Holders only upon receipt by the Trustee or the Paying Agent, in form reasonably satisfactory to it of (i) evidence of the Holder's right to receive such payments, and (ii) evidence, including without limitation any appropriate instruments of assignment, that all of the Holder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Assured Guaranty. Upon and to the extent of such disbursement, Assured Guaranty shall become the Holder of the Obligations, any appurtenant coupon thereto and right to receipt of payment of principal thereof or interest thereon, and shall be fully subrogated to all of the Holder's right, title and interest thereunder, including without limitation the right to receive payments in respect of the Obligations. Payment by Assured Guaranty to the Trustee or the Paying Agent for the benefit of the Holders shall discharge the obligation of Assured Guaranty under this Policy to the extent of such payment.

This Policy is non-cancelable by Assured Guaranty for any reason. The Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment premium or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Assured Guaranty, nor against any risk other than Nonpayment.

Except to the extent expressly modified by any endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "**Avoided Payment**" means any amount previously distributed to a Holder in respect of any Insured Payment by or on behalf of the Issuer, which amount has been recovered from such Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court having competent jurisdiction that such payment constitutes an avoidable preference with respect to such Holder. "**Business Day**" means any day other than (i) a Saturday or Sunday, (ii) any day on which the offices of the Trustee, the Paying Agent or Assured Guaranty are closed, or (iii) any day on which banking institutions are authorized or required by law, executive order or governmental decree to be closed in the City of New York or in the State of Maryland. "**Due for Payment**" means (i) when referring to the principal of an Obligation, the stated maturity date thereof, or the date on which such Obligation shall have been duly called for mandatory sinking fund redemption, and does not refer to any earlier date on which payment is due by reason of a call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity (unless Assured Guaranty in its sole discretion elects to make any principal payment, in whole or in part, on such earlier date) and (ii) when referring to interest on an Obligation, the stated date for payment of such interest. "**Holder**" means, in respect of any Obligation, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Obligation to payment of principal or interest thereunder, except that Holder shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Obligations. "**Insured Payments**" means that portion of the principal of and interest on the Obligations that shall become Due for Payment but shall be unpaid by reason of Nonpayment. Insured Payments shall not include any additional amounts owing by the Issuer solely as a result of the failure by the Trustee or the Paying Agent to pay such amount when due and payable, including without limitation any such additional amounts as may be attributable to penalties or to interest accruing at a default rate, to amounts payable in respect of indemnification, or to any other additional amounts payable by the Trustee or the Paying Agent by reason of such failure. "**Nonpayment**" means, in respect of an Obligation, the failure of the Issuer to have provided sufficient funds to the Trustee or the Paying Agent for payment in full of all principal and interest Due for Payment on such Obligation. It is further understood that the term "Nonpayment" in respect of an Obligation includes any Avoided Payment. "**Receipt**" or "**Received**" means actual receipt or notice of or, if notice is given by overnight or other delivery service, or by certified or registered United States mail, by a delivery receipt signed by a person authorized to accept delivery on behalf of the person to whom the notice was given. Notices to Assured Guaranty may be mailed by registered mail or personally delivered or telecopied to it at 1325 Avenue of the Americas, New York, New York 10019, Telephone Number: (212) 974-0100, Facsimile Number: (212) 581-3268, Attention: Risk Management Department - Public Finance Surveillance, with a copy to the General Counsel, or to such other address as shall be specified by Assured Guaranty to the Trustee or the Paying Agent in writing. A Notice of Nonpayment will be deemed to be Received by Assured Guaranty on a given Business Day if it is Received prior to 12:00 noon (New York City time) on such Business Day; otherwise it will be deemed Received on the next Business Day. "**Term**" means the period from and including the Effective Date until the earlier of (i) the maturity date for the Obligations, or (ii) the date on which the Issuer has made all payments required to be made on the Obligations.

SPECIMEN

At any time during the Term of this Policy, Assured Guaranty may appoint a fiscal agent (the "**Fiscal Agent**") for purposes of this Policy by written notice to the Trustee or the Paying Agent, specifying the name and notice address of such Fiscal Agent. From and after the date of Receipt of such notice by the Trustee or the Paying Agent, copies of all notices and documents required to be delivered to Assured Guaranty pursuant to this Policy shall be delivered simultaneously to the Fiscal Agent and to Assured Guaranty. All payments required to be made by Assured Guaranty under this Policy may be made directly by Assured Guaranty or by the Fiscal Agent on behalf of Assured Guaranty. The Fiscal Agent is the agent of Assured Guaranty only, and the Fiscal Agent shall in no event be liable to the Trustee or the Paying Agent for any acts of the Fiscal Agent or any failure of Assured Guaranty to deposit, or cause to be deposited, sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Assured Guaranty hereby waives, in each case for the benefit of the Holders only, all rights and defenses of any kind (including, without limitation, the defense of fraud in the inducement or in fact or any other circumstance that would have the effect of discharging a surety, guarantor or any other person in law or in equity) that may be available to Assured Guaranty to deny or avoid payment of its obligations under this Policy in accordance with the express provisions hereof. Nothing in this paragraph will be construed (i) to waive, limit or otherwise impair, and Assured Guaranty expressly reserves, Assured Guaranty's rights and remedies, including, without limitation: its right to assert any claim or to pursue recoveries (based on contractual rights, securities law violations, fraud or other causes of action) against any person or entity, in each case, whether directly or acquired as a subrogee, assignee or otherwise, subsequent to making any payment to the Trustee or the Paying Agent, in accordance with the express provisions hereof, and/or (ii) to require payment by Assured Guaranty of any amounts that have been previously paid or that are not otherwise due in accordance with the express provisions of this Policy.

This Policy (which includes each endorsement hereto) sets forth in full the undertaking of Assured Guaranty with respect to the subject matter hereof, and may not be modified, altered or affected by any other agreement or instrument, including, without limitation, any modification thereto or amendment thereof. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW. This Policy will be governed by, and shall be construed in accordance with, the laws of the State of New York.

IN WITNESS WHEREOF, Assured Guaranty has caused this Policy to be affixed with its corporate seal, to be signed by its duly authorized officer, and to become effective and binding upon Assured Guaranty by virtue of such signature.

ASSURED GUARANTY CORP.

(SEAL)

By:_____
[Insert Authorized Signatory Name]
[Insert Authorized Signatory Title]

Signature attested to by:

_____
Counsel

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CITY OF HOUSTON, TEXAS • COMBINED UTILITY SYSTEM, FIRST LIEN REVENUE AND REFUNDING BONDS, SERIES 2009A

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