

**PRELIMINARY OFFICIAL STATEMENT DATED MAY 8, 2013**

IN THE OPINION OF BOND COUNSEL, INTEREST ON THE BONDS IS EXCLUDABLE FROM GROSS INCOME FOR FEDERAL INCOME TAX PURPOSES UNDER EXISTING LAW, AND INTEREST ON THE BONDS IS NOT SUBJECT TO THE ALTERNATIVE MINIMUM TAX ON INDIVIDUALS AND CORPORATIONS, EXCEPT FOR CERTAIN ALTERNATIVE MINIMUM TAX CONSEQUENCES FOR CORPORATIONS. SEE “TAX MATTERS” FOR A DISCUSSION OF BOND COUNSEL’S OPINION, INCLUDING A DESCRIPTION OF CERTAIN ALTERNATIVE MINIMUM TAX CONSEQUENCES FOR CORPORATIONS.

**NEW ISSUE — BOOK-ENTRY ONLY**

**RATINGS:** Standard & Poor’s — “A+”  
Moody’s — “A1”  
Fitch — “A+”  
See “Municipal Bond Ratings” herein

**\$36,005,000\***

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
(A political subdivision of the State of Texas)  
**Water System Revenue Refunding Bonds, Series 2013**

**Dated: June 1, 2013**

**Due: December 15, as set forth on the inside cover**

The West Harris County Regional Water Authority (the “*Authority*”) Water System Revenue Refunding Bonds, Series 2013 (the “*Bonds*”) are limited obligations of the Authority payable solely from and to the extent, and secured equally with the Authority’s outstanding Water System Revenue Bonds (the “*Outstanding Bonds*”) and any future parity bonds by a pledge, of the Pledged Revenues and Pledged Funds of the Authority described herein, including a debt service reserve fund. *The Bonds are not obligations of any governmental unit other than the Authority. The Authority has no ad valorem or other property taxing power.* See “SECURITY AND SOURCE OF PAYMENT.”

The Authority is a political subdivision of the State of Texas created to reduce use of groundwater in, and to supply water to, an approximately 226 square mile, largely suburban area west of Houston, Texas. The Bonds are being issued to (i) defease and refund certain of the Authority’s outstanding parity obligations in order to achieve a net debt service savings, (ii) fund a percentage of the debt service reserve fund, and (iii) pay the costs of issuance of the Bonds. See “THE AUTHORITY” and “SOURCES AND USES OF FUNDS.”

Principal of the Bonds is payable at maturity or earlier redemption at the principal payment office of the Trustee, initially Regions Bank, Houston, Texas (the “*Trustee*”) upon surrender of the Bonds for payment. Interest on the Bonds accrues from June 1, 2013, and is payable each June 15 and December 15, commencing December 15, 2013, until maturity or prior redemption. The Bonds will be issued only in fully registered form. The Bonds will be issued in denominations of \$5,000 each or integral multiples thereof. The Bonds are subject to redemption prior to their maturity, as shown herein. See “THE BONDS.”

The Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York (“*DTC*”), which will act as securities depository for the Bonds. Beneficial owners of the Bonds will not receive physical certificates representing the Bonds, but will receive a credit balance on the books of the nominees of such beneficial owners. So long as Cede & Co. is the registered owner of the Bonds, the principal of and interest on the Bonds will be paid by the Trustee directly to DTC, which will, in turn, remit such principal and interest to its participants for subsequent disbursement to the beneficial owners of the Bonds. See “THE BONDS—Book-Entry-Only System.”

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**See Maturity and Pricing Schedule on the inside cover**

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The Bonds are offered when, as, and if issued by the Authority and accepted by the Underwriters, subject to prior sale, the approving opinion of the Attorney General of Texas, and an opinion of Allen Boone Humphries Robinson LLP, Houston, Texas, Bond Counsel for the Authority. Certain legal matters will be passed upon for the Underwriters by their counsel, Fulbright & Jaworski L.L.P., Houston, Texas. The Bonds are expected to be available for delivery through DTC on or about June 19, 2013.

**SOUTHWEST SECURITIES**

**BOSC, INC.,**  
A SUBSIDIARY OF BOK FINANCIAL CORPORATION

**THE GMS GROUP**

**MESIROW FINANCIAL, INC.**

**RAYMOND JAMES**

**WELLS FARGO SECURITIES**

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\* Preliminary; subject to change.

## MATURITY AND PRICING SCHEDULE

<u>Principal Amount*</u>	<u>Maturity (December 15)</u>	<u>CUSIP Number<sup>(c)</sup></u>	<u>Interest Rate</u>	<u>Initial Reoffering Yield<sup>(a)</sup></u>
\$2,665,000	2017			
2,720,000	2018			
2,800,000	2019			
2,915,000	2020			
3,060,000	2021			
3,215,000	2022			
3,370,000	2023			
3,540,000	2024			
3,720,000	2025			
3,905,000	2026			
4,095,000	2027			

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- (a) Initial yield represents the initial offering yield to the public, which has been established by the Underwriters (as herein defined) for offers to the public and which subsequently may be changed.
- (b) Bonds maturing on or after December 15, \_\_\_\_, are subject to redemption at the option of the Authority prior to their maturity dates in whole, or from time to time, in part, on December 15, \_\_\_\_, or on any date thereafter at a price equal to the principal amount thereof plus unpaid accrued interest from the most recent interest payment date to the date fixed for redemption.
- (c) CUSIP Numbers have been assigned to the Bonds by CUSIP Service Bureau and are included solely for the convenience of the purchasers of the Bonds. Neither the Authority, the Financial Advisor, nor the Underwriters shall be responsible for the selection or correctness of the CUSIP Numbers set forth herein.

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\* Preliminary; subject to change.

# West Harris County Regional Water Authority

## APPOINTED OFFICIALS

<u>Name</u>	<u>Office</u>	<u>Term Expires</u>
Bruce G. Parker	President	May, 2014
Larry L. Weppler	Vice President	May, 2014
Stacey L. Burnett	Assistant Vice President	May, 2014
Douglas C. Postle	Secretary	May, 2016
Eric Hansen	Assistant Secretary	May, 2016
Mark G. Janneck	Director	May, 2016
John Nelson	Director	May, 2014
Karla Cannon	Director	May, 2014
Gary Struzick	Director	May, 2016

## CONSULTANTS AND ADVISORS

Financial Advisor .....	RBC Capital Markets, LLC and First Southwest Company
Bond Counsel.....	Allen Boone Humphries Robinson LLP
Consulting Engineer.....	Dannenbaum Engineering Corporation
Bookkeeper .....	Myrtle Cruz, Inc.
Auditor.....	McCall Gibson Swedlund Barfoot, PLLC
Operator .....	Severn Trent Environmental Services, Inc.

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## USE OF INFORMATION IN THE PRELIMINARY OFFICIAL STATEMENT

The information set forth herein has been furnished by the Authority and includes information obtained from other sources which are believed to be reliable but is not guaranteed as to accuracy or completeness, and is not to be construed as a representation, by the Underwriters. The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Preliminary 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 Authority or the other matters described herein since the date hereof.

For purposes of compliance with Rule 15c2 12 of the Securities and Exchange Commission ("*Rule 15c2 12*"), this document constitutes an Official Statement of the Authority with respect to the Bonds that has been deemed "final" by the Authority as of its date except for the omission of no more than the information permitted by Rule 15c2 12. This document, when further supplemented by adding information specifying the interest rates and certain other information relating to the Bonds, shall constitute a "final official statement" of the Authority with respect to the Bonds, as such term is defined in Rule 15c2 12.

This Preliminary 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 Preliminary Official Statement in its entirety and to each such document, copies of which may be obtained from the Authority or from Allen Boone Humphries Robinson LLP ("*Bond Counsel*"). Any statements made in this Preliminary 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.

Neither the Authority nor the Underwriters make any representations as to the accuracy, completeness, or adequacy of the information supplied by The Depository Trust Company for use in this Preliminary Official Statement.

This Preliminary Official Statement contains "forward-looking" statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, which generally can be identified with words or phrases such as "anticipates," "believes," "could," "estimates," "expects," "foresees," "may," "plan," "predict," "should," "will" or other words or phrases of similar import. All statements included in this Preliminary Official Statement that any person expects or anticipates will, should or may occur in the future are forward-looking statements. These statements are based on assumptions and analyses made in light of experience and perceptions of historical trends, current conditions and expected future developments as well as other factors the Authority believes are appropriate in the circumstances. However, whether actual results and developments conform with expectations and predictions is subject to a number of risks and uncertainties, including, without limitation, the information discussed under "Investment Considerations" in this Preliminary Official Statement, as well as additional factors beyond the Authority's control. The important risk factors and assumptions described under that caption and elsewhere herein could cause actual results to differ materially from those expressed in any forward-looking statement. All of the forward-looking statements made in this Preliminary Official Statement are qualified by these cautionary statements.

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

The Underwriters have provided the following sentence for inclusion in this Preliminary Official Statement. The Underwriters have reviewed the information in this Preliminary Official Statement in accordance with, and as part of, their respective 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.

THE COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY AND IS NOT INTENDED AS A SUMMARY OF THIS OFFERING. INVESTORS SHOULD READ THE ENTIRE PRELIMINARY OFFICIAL STATEMENT, INCLUDING ALL ATTACHED APPENDICES, TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.

## SALE AND DISTRIBUTION OF THE BONDS

No registration statement relating to the offer and sale of the Bonds has been filed with the Securities and Exchange Commission under the Securities Act of 1933, as amended, in reliance upon the exemptions provided thereunder. The Bonds have not been registered or qualified under the Securities Act of Texas in reliance upon various exemptions contained therein and the Bonds have not been registered or qualified under the securities laws of any other jurisdiction. The Authority assumes no responsibility for registration or qualification of the Bonds under the securities laws of any other jurisdiction in which the Bonds may be offered, sold or otherwise transferred. This disclaimer of responsibility for registration or qualification for sale or other disposition of the Bonds shall not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration or qualification provisions in such other jurisdiction.

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 Preliminary Official Statement. Any representation to the contrary may be a criminal offense.

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 dealers 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.

The ultimate parent of First Southwest Company is Hilltop Holdings Inc. (“*Hilltop*”). On July 29, 2011, Hilltop extended a \$50 million term loan to SWS Group, Inc. (“*SWSG*”), which is the parent company of Southwest Securities, Inc. In connection with the term loan, SWSG issued a warrant to Hilltop to purchase 8,695,652 shares of SWSG common stock (the “*Warrant*”), subject to anti-dilution adjustments, which if fully exercised, would represent approximately a 17% equity interest in SWSG, in addition to any shares of SWSG common stock purchased by Hilltop in open market and block transactions. Additionally, Mr. Gerald J. Ford, the Chairman of the Board of Directors of Hilltop, was appointed as a member of the Board of Directors of SWSG. The specific terms of the loan transaction and Hilltop’s beneficial ownership interest in SWSG are summarized in Hilltop’s public filings, which may be found at [www.sec.gov](http://www.sec.gov).

## PRELIMINARY OFFICIAL STATEMENT

**\$36,005,000\***

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**(A political subdivision of the State of Texas)**  
**Water System Revenue Refunding Bonds,**  
**Series 2013**

### INTRODUCTION

This Preliminary Official Statement provides certain information in connection with the offer and sale by the West Harris County Regional Water Authority (the “*Authority*”) of its Water System Revenue Refunding Bonds, Series 2013 (the “*Bonds*”). The Bonds are being issued pursuant to an Indenture of Trust (the “*Master Indenture*”), dated as of August 1, 2003 and Seventh Supplemental Indenture of Trust (the “*Seventh Supplemental Indenture*”), dated as of June 1, 2013 (collectively, the “*Indenture*”), both between the Authority and Regions Bank, as trustee (the “*Trustee*”).

The Authority is a special purpose political subdivision of the State of Texas created by Act of May 28, 2001, 77th Texas Legislature, Regular Session, Chapter 414, 2001 Tex. Gen. Laws, as amended (the “*Act*”). The Authority was created over an approximately 226 square mile, largely suburban area west of Houston, Texas, to reduce the area’s use of groundwater by and to supply water to current and future political subdivisions that operate retail municipal water utility systems in the area (the “*Retail Utilities*”) and/or approximately 55 industrial, commercial and recreational well owners (the “*Private Well Owners*”). The Retail Utilities currently include the City of Katy and approximately 110 utility districts. Approximately 92 of such 110 utility districts own water wells and are therefore subject to the Authority’s imposition of GRP Fees, as described herein. Owners of water wells in the Authority (with certain exceptions described herein) have been ordered by the Harris Galveston Subsidence District (the “*HGSD*”) for the wells in Harris County to individually or collectively convert to at least 30% alternate source water (e.g., surface water) use by 2010, 60% alternate source water use by 2025, and 80% alternate source water use by 2035. (The approximately five water wells in the Authority located in Fort Bend County are subject to Fort Bend Subsidence District (“*FBSD*”) conversion requirements. See CAPITAL IMPROVEMENT PLANS – Groundwater Reduction Mandate” herein.) To enable the area to convert, the Authority has entered into a water supply contract, as amended (the “*Supply Contract*”) with the City of Houston, Texas (the “*City of Houston*” or “*Houston*”) to secure a long-term supply of treated surface water from the City of Houston, and the Authority has constructed, and will need to continue to construct, a network of transmission lines and storage tank and pumping station facilities to convey purchased water to certain Retail Utilities, Contract Retail Utilities and/or Private Well Owners. In addition, the Authority has agreed by contract to include seven political subdivisions (“*Contract Retail Utilities*”) that are located outside the Authority’s boundaries into the Authority’s groundwater reduction plan, as amended (“*GRP*”). See “THE AUTHORITY” and “CAPITAL IMPROVEMENT PLANS” herein. See Appendix B for a list of the Retail Utilities and Contract Retail Utilities that own water wells and therefore pay GRP fees.

The Bonds are being issued as “Parity Bonds” under the Indenture. The Bonds (together with the Outstanding Bonds and any future parity obligations) are limited obligations of the Authority payable solely from and to the extent of its Pledged Revenues and Pledged Funds pledged for that purpose under the Indenture. Pledged Revenues consist of Net Revenues (hereinafter described) and amounts transferred from the Authority’s Coverage Fund to its Revenue Fund (as hereinafter described). The Net Revenues consist primarily of collections of groundwater pumpage fees/user fees (“*GRP Fees*”) imposed by the Authority and water sale revenues (“*Water Sale Fees*”) remaining after payment of the Authority’s maintenance and operating expenses.

The GRP Fee is currently \$1.75 per 1,000 gallons of water pumped from wells owned by the Retail Utilities, Contract Retail Utilities and the Private Well Owners and will increase to \$1.90 per 1,000 gallons effective July 1, 2013, which is budgeted to generate \$24,077,250 for the fiscal year ending December 31, 2013. The Authority’s Water Sale Fee is currently \$2.15 per 1,000 gallons of water sold and delivered by the Authority, and will increase to \$2.30 per 1,000 gallons effective July 1, 2013, which is budgeted to generate \$18,910,000 for the fiscal year ending December 31, 2013. The Authority collects Water Sale Fees from the Retail Utilities receiving water from the System, to the extent of water received, and collects GRP Fees from the Retail Utilities, Contract Retail Utilities and Private Well Owners pumping groundwater, to the extent of groundwater pumped. See “SECURITY AND SOURCE OF PAYMENT” herein.

Descriptions and summaries of the Bonds, the Authority, the Indenture, and the Supply Contract are included in this Preliminary Official Statement. Certain terms used herein are defined in Appendix C to this Preliminary Official Statement. References herein to the Bonds and the Indenture are qualified in their entirety by reference to the Indenture and the form of the Bonds included therein. The Authority’s financial statements for its fiscal year ended December 31, 2012, are included in Appendix A to this Preliminary Official Statement.

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\* Preliminary; subject to change.

## PLAN OF FINANCING

### **Purpose**

Proceeds of the Bonds, together with legally available funds of the Authority, are being used to refund and defease \$47,390,000\* in principal amount of the Authority's Water System Revenue Bonds, Series 2003 (the "*Refunded Bonds*") in order to achieve a net debt service savings. The proceeds of the Bonds will also be used to pay costs of issuance and to fund a percentage of the Debt Service Reserve Fund. A total of \$269,790,000\* in principal amount of the Outstanding Bonds (the "*Remaining Outstanding Bonds*") will remain outstanding after the issuance of the Bonds and the consummation of this refunding and defeasance.

### **Outstanding Bonds**

The following table lists the original principal amount of Outstanding Bonds, the current principal balance of the Outstanding Bonds, and the principal amount of the Remaining Outstanding Bonds.

<u>Series</u>	<u>Original Principal Amount</u>	<u>Principal Currently Outstanding</u>	<u>Refunded Bonds*</u>	<u>Remaining Outstanding Bonds*</u>
2003	\$72,950,000	\$59,330,000	\$47,390,000	\$11,940,000
2005	71,795,000	64,845,000		64,845,000
2006	47,000,000	42,685,000		42,685,000
2007	53,855,000	50,580,000		50,580,000
2009	60,000,000	58,575,000		58,575,000
2012	<u>41,965,000</u>	<u>41,165,000</u>	<u>                    </u>	<u>41,165,000</u>
Total	\$347,565,000	\$317,180,000	\$47,390,000	\$269,790,000
The Bonds				<u>36,005,000*</u>
The Bonds and the Remaining Outstanding Bonds				\$305,795,000*

### **Refunded Bonds**

A portion of the proceeds of the Bonds will be applied to refund the Refunded Bonds in the principal amounts and on the maturity dates set forth below.

<u>Maturity Date</u> <u>December 15</u>	<u>Principal Amount</u> <u>Series 2003*</u>
2017	\$3,355,000
2018	3,525,000
2019	3,700,000
2020	3,885,000
2021	4,055,000
2022	4,260,000
2023	4,470,000
2024	4,695,000
***	
***	
2027	15,445,000 <sup>(a)</sup>

Redemption Date: December 15, 2013

- (a) consisting of a term bond in the aggregate principal amount of \$15,445,000, subject to mandatory redemption in the amount of \$4,915,000 in 2025 and in the amount of \$5,145,000 in 2026, with the remaining \$5,385,000 due at stated maturity on December 15, 2027.

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\* Preliminary; subject to change.



## **Defeasance of Refunded Bonds**

The Refunded Bonds, and the interest due thereon, are to be paid on each principal or interest payment date and on the redemption date from funds to be deposited with Regions Bank, as escrow agent (the "*Escrow Agent*").

The resolution adopted by the Board of Directors of the Authority in connection with the Bonds provides that the Authority and the Escrow Agent will enter into an escrow agreement (the "*Escrow Agreement*") to provide for the discharge and defeasance of the Refunded Bonds. The Seventh Supplemental Indenture provides that from the proceeds of the sale of the Bonds and other legally available funds of the Authority, the Authority will deposit with the Escrow Agent the amount necessary to accomplish the discharge and final payment of the Refunded Bonds. Such funds will be held by the Escrow Agent in a segregated escrow account (the "*Escrow Fund*") and used to purchase United States Treasury Obligations (the "*Escrowed Securities*"). At the time of delivery of the Bonds, Grant Thornton, LLP, will verify to the Authority, the Escrow Agent and the Underwriters that the Escrowed Securities are sufficient in principal amount and are scheduled to mature at such times and to yield interest in such amounts, together with uninvested funds, if any, in the Escrow Fund, to pay, when due, the principal of and interest on the Refunded Bonds. Under the Escrow Agreement, the Escrow Fund is irrevocably pledged to the payment of principal of and interest on the Refunded Bonds and will not be available to pay principal of and interest on the Bonds. By the deposit of the Escrowed Securities and cash with the Escrow Agent pursuant to the Escrow Agreement, and the making of irrevocable arrangements for the giving of notice of redemption of the Refunded Bonds, the terms of the Master Indenture and First Supplemental Indenture of Trust dated as of August 1, 2003, securing payment of the Refunded Bonds shall have been satisfied and such Refunded Bonds will no longer be considered outstanding except for the payment out of amounts so deposited, and the amounts so deposited and invested in the Escrow Fund will constitute firm banking arrangements under Texas law for the discharge and final payment of the Refunded Bonds. See "VERIFICATION OF MATHEMATICAL CALCULATIONS."

## **SOURCES AND USES OF FUNDS**

The proceeds derived from the sale of the Bonds will be applied as follows:

### **Sources:**

Principal amount of Bonds.....	\$
Accrued Interest .....	
Net Premium .....	
Transfer from Authority's Improvement Fund.....	
Total Sources of Funds .....	\$

### **Uses:**

Refunding Escrow Deposits	
Cash Deposit .....	\$
SLGS Purchases .....	
Other Fund Deposits .....	
Costs of issuance, including underwriters' discount .....	
Total Uses of Funds .....	\$

## **THE BONDS**

### **General**

The Bonds will mature on December 15 of the years and in the principal amounts, and will bear interest from June 1, 2013, at the rates, specified on the inside cover page. Interest on the Bonds will be payable on each June 15 and December 15, commencing December 15, 2013. Interest will be calculated on the basis of a 360-day year of twelve 30-day months. The record date for payment of the interest on any regularly scheduled interest payment date is defined as the 30<sup>th</sup> day of the calendar month (whether or not a business day) immediately preceding such interest payment date.

The Bonds will be issuable only in book-entry form, in denominations of \$5,000 and integral multiples of \$5,000, through the facilities of The Depository Trust Company. See "Book-Entry-Only System" herein.

The Authority has appointed Regions Bank as its Paying Agent/Registrar (the "*Paying Agent/Registrar*") to register ownership of and make the payments on the Bonds.

### **Redemption**

***Optional Redemption.*** The Bonds due on or after December 15, \_\_\_, are subject to redemption at the option of the Authority prior to their scheduled maturities, in whole or from time to time in part, in integral multiples of \$5,000 on December

15, \_\_\_, or any date thereafter, at a price equal to 100% of principal amount plus accrued interest to the date fixed for redemption.

#### ***Mandatory Sinking Fund Redemption.***

If any Bonds are issued as term bonds, they will be subject to mandatory sinking fund redemption by the Authority on December 15 of the years in which serial Bonds do not mature and in the principal amounts specified on the cover page, at a redemption price equal to 100% of the principal amount.

The principal amount of any Bonds to be mandatorily redeemed on a mandatory redemption date shall be reduced by the principal amount of such Bonds which, by the 45<sup>th</sup> day prior to such mandatory redemption date, either have been purchased in the open market and delivered or tendered for cancellation by or on behalf of the Authority to the Trustee or optionally redeemed and which, in either case, have not previously been made the basis for a reduction under this sentence. In addition, if in the exercise of its right of optional redemption, the Authority has redeemed part but not all of the Bonds of a particular maturity, the principal amount to be mandatorily redeemed on the next mandatory redemption date or dates following the date of such optional redemption shall be reduced by the principal amount optionally redeemed and which has not previously been made the basis for a reduction under this sentence.

***Redemption Procedures.*** Bonds of a denomination larger than \$5,000 may be redeemed in part (\$5,000 or any multiple thereof). If less than all the Bonds are redeemed at any time, the maturities of the Bonds to be redeemed shall be selected by the Authority. If less than all of the Bonds of a certain maturity are to be redeemed, the particular Bonds or portions thereof to be redeemed will be selected by the Authority prior to the redemption date by such random method as the Authority shall deem fair and appropriate (or by DTC in accordance with its procedures while the Bonds are in book-entry-only form).

Notice of any redemption identifying the Bonds to be redeemed in whole or in part shall be given by the Trustee at least thirty (30) days prior to the date fixed for redemption by sending written notice by first class mail to the owner of each Bond to be redeemed in whole or in part at the address shown on the bond register. Such notices shall state the redemption date, the redemption price, the place at which the Bonds are to be surrendered for payment and, if less than all the Bonds outstanding are to be redeemed, the numbers of the Bonds or the portions thereof to be redeemed. Any notice given shall be conclusively presumed to have been duly given, whether or not the owner receives such notice. By the date fixed for redemption, due provision shall be made with the Trustee for payment of the redemption price of the Bonds or portions thereof to be redeemed, plus accrued interest to the date fixed for redemption. When Bonds have been called for redemption in whole or in part and due provision has been made to redeem the same as herein provided, the Bonds or portions thereof so redeemed shall no longer be regarded as outstanding except for the purpose of receiving payment solely from the funds so provided for redemption, and the rights of the owners to collect interest which would otherwise accrue after the redemption date on any Bond or portion thereof called for redemption shall terminate on the date fixed for redemption.

#### **Payment Record**

The Authority has never defaulted in the timely payment of any previously issued bonds.

#### **Source of Payment**

The Bonds are being issued as "Parity Bonds" under the Indenture. The Bonds are limited obligations of the Authority payable solely from, and secured (together with the Remaining Outstanding Bonds and any future Parity Bonds, Parity Notes, and Parity Obligations) by a lien on and pledge of, the Pledged Revenues and Pledged Funds. The Bonds are obligations solely of the Authority and are not obligations of the State of Texas, the City of Houston, Harris County, Fort Bend County, any of the Retail Utilities, Contract Retail Utilities, Private Well Owners, or any entity other than the Authority. The Bonds do not constitute a general obligation of the Authority and are not payable from funds raised or to be raised by ad valorem or other property taxes. The Authority has no property taxing power. See "SECURITY AND SOURCE OF PAYMENT" herein.

#### **Authority for Issuance**

The Bonds are being issued pursuant to Texas Law (including particularly the Act and Chapter 1207 of the Texas Government Code, as amended), the Indenture and a resolution adopted by the board of directors of the Authority.

Before the Bonds can be issued, the Attorney General of Texas must pass upon the legality of certain related matters. The Attorney General of Texas does not guarantee or pass upon the safety of the Bonds as an investment or upon the adequacy of the information contained in this Preliminary Official Statement.

## BOOK-ENTRY-ONLY SYSTEM

*The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority takes no responsibility for the accuracy or completeness thereof. The Authority cannot and does not give any assurances that DTC, DTC Direct Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of interest, principal or premium, if any, with respect to the Bonds, (b) Bonds representing ownership interest in or other confirmation or ownership interest in the Bonds, or (c) prepayment or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Bonds, or that they will so do on a timely basis or that DTC, DTC Direct Participants or DTC Indirect Participants will act in the manner described in this Preliminary Official Statement. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedure" of DTC to be followed in dealing with DTC Direct Participants are on file with DTC.*

### **General**

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for 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 each maturity of 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 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 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 is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. 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 rating of AA+. 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](http://www.dtcc.com).

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 affect 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.

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 MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority (or the Paying Agent on behalf thereof) 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 payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or Paying Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Paying Agent, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, if any, interest payments and redemption proceeds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the Authority or the Paying Agent. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

The Authority 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.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority takes no responsibility for the accuracy thereof.

### **Limitations**

For so long as the Bonds are registered in the name of DTC or its nominee, Cede & Co., the Authority and the Paying Agent will recognize only DTC or its nominee, Cede & Co., as the registered owner of the Bonds for all purposes, including payments, notices and voting.

Because DTC is treated as the registered owner of the Bonds for substantially all purposes under the Indenture, Beneficial Owners may have a restricted ability to influence in a timely fashion remedial action or the giving or withholding of requested consents or other directions. In addition, because the identity of Beneficial Owners is unknown to the Authority, to DTC or to the Paying Agent, it may be difficult to transmit information of potential interest to Beneficial Owners in an effective and timely manner. Beneficial Owners should make appropriate arrangements with their broker or dealer regarding distribution of information regarding the Bonds that may be transmitted by or through DTC.

Payments made by the Paying Agent to DTC or its nominee will satisfy the Authority's obligations, whether or not such payments are credited to Beneficial Owners.

Neither the Authority nor the Paying Agent will have any responsibility or obligation with respect to: (i) the accuracy of the records of DTC, its nominee or any DTC Participant or Indirect Participant with respect to any beneficial ownership interest in any Bonds; (ii) the delivery to any DTC Participant or Indirect Participant or any other Person, other than a registered owner, of any notice or other document, including, without limitation, any notice of redemption with respect to any Bond; (iii) the payment to any DTC Participant or Indirect Participant or any other Person, other than a registered owner, of any amount with respect to the principal of, premium, if any, interest on, or redemption price of any Bond; (iv) the selection of the Beneficial Owners to receive payment in the event of any partial redemption of the Bonds; or (v) any consent given or other action taken by DTC as registered owner.

Prior to any discontinuation of the book-entry system with respect to the Bonds, the Authority and the Paying Agent may treat DTC as, and deem DTC to be, the absolute owner of the Bonds for all purposes whatsoever, including, without limitation, (i) the payment of principal, premium, if any, and interest on Bonds; (ii) giving notices of redemption and other matters with respect to the Bonds; (iii) registering transfers with respect to the Bonds; and (iv) the selection of Bonds for redemption.

### **Use of Certain Terms in Other Sections of this Preliminary Official Statement**

In reading this Preliminary Official Statement it should be understood that while the Bonds are in the Book-Entry-Only System, references in other sections of this Preliminary 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 Indenture will be given only to DTC.

## SECURITY AND SOURCE OF PAYMENT

### **Pledged Revenues and Pledged Funds**

The Bonds are special obligations of the Authority payable solely from and equally and ratably secured (together with the Remaining Outstanding Bonds and future parity obligations) by a lien on the Pledged Revenues and Pledged Funds.

### **Definitions**

As used in this Preliminary Official Statement, in addition to the terms defined elsewhere in this Preliminary Official Statement and in Appendix C, the following terms have the following meanings:

“*Coverage Fund Requirement*” shall mean, for the Bonds, Remaining Outstanding Bonds, and other Parity Bonds, Notes and Obligations, 25% of their Maximum Annual Debt Service Requirements.

“*Gross Revenues*” shall mean all revenues derived by the Authority from the imposition of fees, user fees, rates and charges for or related to the sale of water from the System (including standby fees, capacity charges and transportation fees and other fees, user fees, rates and charges for the use, services or availability of the System); fees, user fees, rates and charges imposed for the use, services or benefits derived from the GRP or other groundwater withdrawal conservation efforts (including those imposed for the pumpage of water from water wells and those imposed for regulatory purposes); fees, user fees, or charges for the importation of water into the Authority’s boundaries; interest earned on amounts credited to any Pledged Funds; and any other receipts from time to time designated as Gross Revenues by the Authority. The Authority has provided in a supplemental indenture that Gross Revenues shall also mean any payments received from the North Fort Bend Water Authority under Section 10.1 of the Joint Facilities Agreement. Gross Revenues do not include any fees, user fees, rates, charges or receipts of revenues for Authority property outside the System or for fees or charges which by law may not be applied for the purposes to which Pledged Revenues are dedicated under the Indenture. Nor shall Gross Revenues include credits (including reimbursement credits) issued heretofore or hereafter by the Authority pursuant to State law (including Section 4.04 of the Act) or pursuant to contracts or policies of the Authority.

“*Joint Facilities Agreement*” shall mean the Joint Facilities Agreement for Segments 0 & 1A, Bellaire Pump Station, and Second Source Waterline/Pump Stations between the Authority and North Fort Bend Water Authority dated July 1, 2011, as amended, including without limitation the First Amendment to Joint Facilities Agreement for Segments 0 & 1A, Bellaire Pump Station and Second Source Waterline/Pump Stations, dated March 1, 2012.

“*Net Revenues*” shall mean Gross Revenues less Operating and Maintenance Expenses.

“*Operating and Maintenance Expenses*” shall mean all current expenses of operating and maintaining the System and administering the GRP, including water purchase expenses, water treatment expenses, water transmission and distribution expenses together with the salaries, labor, materials and administrative expenses that are allocable to the System or the GRP, but shall expressly exclude depreciation, capital costs of the System and major repair and replacement costs.

“*Pledged Funds*” shall mean the following:

- (a) for the Bonds, Remaining Outstanding Bonds, and other Parity Bonds, Parity Notes and Parity Obligations, the Revenue Fund, the Debt Service Fund, the Debt Service Reserve Fund and the Coverage Fund; and
- (b) for Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations, the Revenue Fund, Junior Lien Debt Service Fund, the Junior Lien Debt Service Reserve Fund and the Coverage Fund; and
- (c) for any Series of Bonds or Notes or any Obligation, such additional Funds or Accounts as shall be pledged by Supplemental Indenture.

“*Pledged Revenues*” shall mean:

- (a) Net Revenues; plus
- (b) amounts transferred to the Revenue Fund from the Coverage Fund; plus

- (c) any additional revenues hereafter designated as Pledged Revenues.

*“Reserve Fund Requirement”* shall mean for the Bonds, Remaining Outstanding Bonds and other Parity Bonds and Notes the lesser of (i) Maximum Annual Debt Service Requirements or (ii) 125% of average annual Aggregate Debt Service on the Parity Bonds and Parity Notes (the *“Parity Reserve Fund Requirement”*), calculated as of the date of issuance of each Series, which calculations shall take into account the issuance of the Series of Bonds, Notes or Obligations being issued or incurred as of the date of calculation. For the Bonds and Remaining Outstanding Bonds, the combined Reserve Fund Requirement initially shall be approximately \$24,611,759.61\* and shall be satisfied by a debt service reserve surety bond issued by Financial Security Assurance, Inc. (*“FSA”*) in the amount of \$5,748,250 in connection with the issuance of the Series 2005 Bonds, by a debt service reserve surety bond issued by Ambac Assurance Corporation (*“Ambac”*) in the amount of \$3,592,711.26 in connection with the issuance of the Series 2006 Bonds, by a debt service reserve surety bond issued by MBIA Insurance Corporation (*“MBIA”*) in the amount of \$4,121,128.74 in connection with the issuance of the Series 2007 Bonds, by a cash deposit of \$6,711,011.26 from the proceeds of the Series 2009 Bonds and the Series 2012 Bonds, and, as for the balance of the Reserve Fund Requirement, by a cash deposit of \$2,219,854.17\* from the proceeds of the Bonds and a transfer of \$2,219,854.18\* from the Authority’s Improvement Fund. While the debt service reserve surety bond issued by MBIA in the amount of \$5,641,472.50 in connection with the issuance of the Series 2003 Bonds will remain in place until all of the Series 2003 Bonds have been paid or defeased, the Authority is not including such debt service reserve surety bond in its calculations for satisfying the Reserve Fund Requirement. (See [www.nationalpfg.com](http://www.nationalpfg.com) for information provided by National Public Finance Guarantee Corporation regarding assumption of certain policies from MBIA. The Authority makes no representation regarding the accuracy of such information.) The Reserve Fund Requirement for Junior Lien Bonds and Junior Lien Notes (the *“Junior Lien Reserve Fund Requirement”*) shall have such meaning as shall be provided by Supplemental Indenture. See *“INVESTMENT CONSIDERATIONS — Risk Factor Related to Debt Service Reserve Surety Policies.”*

### **Flow of Funds**

The Indenture provides that all Gross Revenues must be deposited as collected into the Revenue Fund held by the Trustee, and that amounts in the Coverage Fund up to the Coverage Fund Requirement shall be transferred to the Revenue Fund on the first business day of each calendar year. Monies from time to time on deposit to the credit of the Revenue Fund must be applied in the following manner and in the following order of priority:

First, on or before the last business day of each month, the Trustee shall transfer to the Authority for credit to the O&M Fund the Monthly O&M Transfer Amount for the following month to be applied by the Authority for Operation and Maintenance Expenses.

Second, on or before the last business day of each month, and at such other times as shall be set forth in any Supplemental Indenture (but only after making the transfer required above), the Trustee shall transfer to the Debt Service Fund, amounts which, when added to other amounts in the Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Debt Service on all Parity Bonds, Parity Notes and Parity Obligations.

Third, if the Debt Service Reserve Fund contains less than the Reserve Fund Requirement, on or before the last business day of each month (but only after making the transfers required above), the Trustee shall transfer to the Debt Service Reserve Fund the amount required by a Supplemental Indenture to attain or re-establish the Reserve Fund Requirement, which transfers shall continue until the Debt Service Reserve Fund contains the Reserve Fund Requirement.

Fourth, when and if Junior Lien Bonds, Junior Lien Notes or Junior Lien Obligations have been issued and are Outstanding, on or before the last business day of each month, and at such other times as shall be set forth in any Supplemental Indenture (but only after making all transfers required above), the Trustee shall transfer to the Junior Lien Debt Service Fund, amounts which, when added to other amounts in the Junior Lien Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Junior Lien Debt Service on all Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations.

Fifth, when and if Junior Lien Bonds, Junior Lien Notes or Junior Lien Obligations have been issued and are Outstanding, if the Junior Lien Debt Service Reserve Fund contains less than the Reserve Fund Requirement, on or before the last business day of each month (but only after making all transfers required above), the Trustee shall transfer to the Junior Lien Debt Service Reserve Fund the amount required by a Supplemental Indenture to attain or re-establish the Reserve Fund Requirement, which transfers shall continue until the Junior Lien Debt Service Reserve Fund contains the Reserve Fund Requirement.

Sixth, whenever the Coverage Fund contains less than the Coverage Fund Requirement, on or before the last business day of each month (but only after making all transfers required above), the Trustee shall transfer to the Coverage Fund to the extent funds are available in the Revenue Fund (i) in the first month of such Fiscal Year, an amount sufficient to produce a

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\* Preliminary; subject to change.

balance in the Coverage Fund equal to the Coverage Fund Requirement, and (ii) in each succeeding month, one-twelfth of the Coverage Fund Requirement until the Coverage Fund Requirement has been re-established.

Seventh, whenever the balance in the O&M Reserve Account contains less than two months (or any greater period designated by the Authority) of Operation and Maintenance Expenses according to the Authority's then current budget, on or before the last business day of each month (but only after making all transfers required above) the Trustee shall transfer to the Authority for credit to the O&M Reserve Account the amount necessary to re-establish such balance.

Eighth, on or before the last business day of each month (but only after making all transfers required above), all remaining amounts shall be transferred to the Improvement Fund. To the extent available, amounts in the Improvement Fund shall be transferred to the Debt Service Fund and Junior Debt Service Fund to the extent required to pay principal and/or interest on any Bonds, Notes or Obligations as they become due and payable. In addition, in the event the Coverage Fund Requirement is not established in the Coverage Fund on the last Business Day of the penultimate month of each Fiscal Year, after all transfers required under the Indenture have been made, the Trustee shall send the Authority an invoice by the first Business Day of the last month of such Fiscal Year for the additional amount needed to re-establish the Coverage Fund Requirement by the end of such Fiscal Year. The Authority shall pay to the Trustee from the Improvement Fund for credit to the Coverage Fund the amount of such invoice within 30 days of the date of the invoice.

### **Debt Service Reserve Fund**

Under the Indenture, the Authority is required to maintain separate debt service reserve funds for the Parity Bonds and the Junior Lien Bonds. The Indenture provides as follows regarding the Debt Service Reserve Fund for Parity Bonds, including the Bonds:

If on any Interest Payment Date, principal payment date, or any other date, after giving effect to all transfers to the Debt Service Fund, the amount in the Debt Service Fund shall be less than the amount required to make all payments of interest, principal, and any redemption price, of the Parity Bonds and Parity Notes then due and payable or to make any other then required payments on Parity Obligations, the Trustee shall apply amounts from the Debt Service Reserve Fund to the extent necessary to make such payments.

In lieu of cash or Investment Securities, the Reserve Fund Requirement for the Debt Service Reserve Fund may be satisfied in whole or in part with one or more Debt Service Reserve Fund Surety Policies. Such Debt Service Reserve Fund Surety Policies may be drawn upon on a proportionate basis only after all other amounts in the Debt Service Reserve Fund have been used or applied. In the event the Debt Service Reserve Fund holds one or more Debt Service Reserve Fund Surety Policies, any Pledged Revenues required to be deposited into the Debt Service Reserve Fund shall first be used on a proportionate basis to reimburse and repay issuers of Debt Service Reserve Fund Surety Policies for amounts drawn thereon together with interest thereon and related costs, all as may be more fully provided by Supplemental Indenture. See "INVESTMENT CONSIDERATIONS — Risk Factor Related to Debt Service Reserve Surety Policies."

### **Rate Covenant**

The Indenture provides that the Authority shall fix, charge and collect fees, user fees, rates and charges which, in the aggregate, are calculated to be fully sufficient to generate Gross Revenues adequate to produce either:

- (i) Pledged Revenues in each Fiscal Year which, together with balances in the O&M Reserve Account and Improvement Fund at the end of such Fiscal Year, are at least equal to 120% of the principal and interest and other payment requirements scheduled to occur in such Fiscal Year on all Parity Bonds, Parity Notes and Parity Obligations then Outstanding; or
- (ii) Net Revenues in each Fiscal Year which are at least equal to 110% of the principal and interest and other payment requirements scheduled to occur in such Fiscal Year on all Parity Bonds, Parity Notes and Parity Obligations then Outstanding.

In fixing, charging and collecting fees, user fees, rates and charges, the Authority shall take into account all credits (including reimbursement credits) issued heretofore or hereafter by the Authority pursuant to Texas law (including Section 4.04 of the Act) or pursuant to contracts or policies of the Authority.

The Authority has agreed to exercise its power to impose and collect fees, user fees, or charges for the importation of water into the Authority's boundaries, if determined necessary by the Authority and as allowed by the Act, in order to satisfy the Authority's obligations under the Indenture. The Authority has adopted a fee for the importation of water into the Authority's boundaries, as set forth in the Authority's Amended Rate Order. With certain limited exceptions, this fee generally applies to water produced outside the Authority's boundaries and transported into the Authority for distribution to an end user within the Authority if the water is imported by an entity located within the Authority's boundaries that: (i) uses or distributes the imported

water; and (ii) uses or distributes more than 10,000,000 gallons of water in a calendar year. The fee for importation of water is: (i) a fee equal to the then-current GRP Fee applied on all imported water, if the Authority's System has not been directly connected to the water importer's water supply facilities; or (ii) a fee equal to the then-current Water Sale Fee applied on all imported water, if the Authority's System has been directly connected to the water importer's water supply facilities. However, a water importer is not required to pay the fee: (i) on imported water if the Authority has agreed in writing that no imported water fee applies to the particular imported water; (ii) on imported water that the water importer receives during a period not to exceed 60 consecutive or inconsecutive days during any calendar year if the water importer receives the imported water due to emergency conditions; or (iii) as provided in Section 4.03(g) of the Act, on water imported from a source located in Waller County that serves a municipality within the Authority.

The Authority will not grant or permit any free service from or use of the GRP or System, except to the Authority or as may be authorized by law.

If the Pledged Revenues in any Fiscal Year are less than the amount specified above, the Authority, promptly upon receipt of the annual audit for such Fiscal Year, must request an independent nationally recognized rate consultant to make its recommendations, if any, as to a revision of the Authority's rates, fees and charges, its budgeted Operation and Maintenance Expenses or its method of operation of the System in order to satisfy as quickly as practicable the foregoing requirements. A copy of such request and recommendations of such consultant shall be filed with the Trustee. So long as the Authority substantially complies in a timely fashion with the recommendation contained in such report, the Authority will not be deemed to have defaulted in a performance of its duties under the Rate Covenant described above even if the resulting Pledged Revenues are not sufficient to be in compliance with the covenant set forth above, so long as there is no other default under the Indenture and the Debt Service Reserve Fund is fully funded.

#### **Additional Bonds**

The Indenture provides that no additional Series of Parity Bonds or Parity Notes shall be issued, nor shall any Parity Obligations be incurred, unless there shall have been submitted to the Trustee:

(a) **Historical Pledged Revenues.** Pledged Revenues for the most recent Fiscal Year or 12 consecutive months out of the most recent 18 months, plus the amount in the Improvement Fund on the last Business Day for the most recent Fiscal Year, shall be certified by an independent certified public accountant for the Authority to have been at least equal to 120% of Maximum Annual Debt Service Requirements on all Parity Bonds, Parity Notes and Parity Obligations that will be outstanding after the issuance of such Series of Parity Bonds or Parity Notes or incurrence of such Parity Obligations; or

(b) **Proforma Pledged Revenues.** The certification of an independent nationally recognized rate consultant to the effect that, based upon a recent increase in rates or charges imposed by the Authority, the Pledged Revenues of the Authority for the prior Fiscal Year or 12 consecutive months out of the most recent 18 months, calculated as if such increase in rates or charges had been effective during such a period, plus the amount in the Improvement Fund on the last Business Day for the most recent Fiscal Year, would have produced Pledged Revenues equal to at least 130% of Maximum Annual Debt Service Requirements for Parity Bonds, Parity Notes and Parity Obligations that will be outstanding after the issuance of such Series of Parity Bonds or Parity Notes or incurrence of such Parity Obligations; or

(c) **Projected Pledged Revenues.** The certification of an independent nationally recognized rate consultant to the effect that, based on the certification of an independent professional engineer described below, the projected Pledged Revenues for the first future Fiscal Year for which interest has not been capitalized for the Series of Parity Bonds or Parity Notes to be issued or Parity Obligation to be incurred, plus the amount in the Improvement Fund on the last Business Day for the most recent Fiscal Year, will be at least equal to 130% of Maximum Annual Debt Service Requirements on all Parity Bonds, Parity Notes and Parity Obligations that will be outstanding after the issuance of such Series of Parity Bonds or Parity Notes or incurrence of such Parity Obligations. Such certification may rely on the certification of an independent professional engineer that forecasts the levels of (i) water pumpage within the Authority and within its GRP during a forecast period; and/or (ii) water sales by the Authority during a forecast period based upon such engineer's evaluation of the Authority's anticipated construction and placement into service of components of the System that will permit the Authority to increase its sales of water during the forecast period.

(d) **Special Rule for Refunding.** If Parity Bonds or Parity Notes are being issued or Parity Obligations are being incurred for the purpose of refunding previously issued Parity Bonds or Parity Notes or previously incurred Parity Obligations, none of the foregoing certifications will be required so long as the issuance of such Parity Bonds or Parity Notes, or incurrence of Parity Obligations, is certified by the Authority's financial advisor not to cause an increase in the Maximum Annual Debt Service Requirements of the Parity Bonds, Parity Notes and Parity Obligations.



The Authority's capital improvement plans anticipate the issuance of a substantial amount of additional System revenue bonds to finance the capital improvements to the System. Such plans, including the amount and timing of obligations to be issued, are subject to revision. See "CAPITAL IMPROVEMENT PLANS — Projected Capital Expenditures" herein.

#### **Other Covenants**

An excerpt from the Indenture containing other covenants of the Authority is included in Appendix C.

#### **Amendments to Indenture**

An excerpt from the Indenture containing provisions concerning amendments and supplements to the Indenture, including certain amendments and supplements that may require the consent of some or all of the owners of the Bonds, is included in Appendix C.

#### **Concerning the Trustee**

An excerpt from the Indenture containing provisions concerning the Trustee is included in Appendix C.

### **THE AUTHORITY**

#### **General**

The Authority is a special purpose political subdivision of the State of Texas created in 2001 by the Act. The Authority has jurisdiction over an approximately 226 square mile, largely suburban area located west of Houston, Texas. The boundaries of the Authority are generally U. S. Highway 290 on the north/northeast, the City of Houston limits on the east, the Harris-Fort Bend County line on the south (although a small portion of Fort Bend County is included within the Authority) and the Harris/Waller County line on the west. See Appendix E for a map of the boundaries of the Authority. The Authority was created to assist the area within its boundaries in converting from groundwater to alternate water sources of water (*e.g.*, surface water) in accordance with mandates imposed by the HGSD and FBSD. See "CAPITAL IMPROVEMENT PLANS – Groundwater Reduction Mandate" herein.

#### **Powers**

The Authority has the statutory power to conserve groundwater; to acquire or develop surface water and groundwater supplies; to acquire, construct, operate, and maintain a water treatment or supply system; to transport, treat, and sell water to others; to allocate water among participants in its groundwater reduction plan; and to coordinate water services. The Authority is also empowered to establish and enforce a mandatory groundwater reduction plan. The plan may require reduced usage of groundwater by specified dates and identify the rates, terms, and conditions under which alternative sources of water will be provided. The Authority may also adopt rules regarding its water supply and groundwater reduction plan, establish fees and charges as described herein, and impose special assessments on defined areas that specifically benefit from an improvement project or service. The Authority has not imposed special assessments and does not currently expect to impose such assessments.

#### **Ratemaking Authority**

The Authority has the statutory power to establish fees, user fees, rates, and charges (and to classify fee and rate-payers) as necessary to enable the Authority to achieve its purposes and fulfill its regulatory functions. Subject to the limitations described below, the Authority may impose fees, user fees, rates and charges on any person within the Authority, including governmental units. The Authority is expressly authorized to charge the owners of wells within the Authority a fee based on water pumped, except for classes of wells exempt from groundwater reduction requirements imposed by the HGSD (for wells located in Harris County) and the FBSD (for wells located in Fort Bend County), any wells with a casing diameter of less than five inches serving a single dwelling, and injection wells. The Authority has the power to exempt additional categories of wells from its GRP and the imposition of GRP Fees. Per the statute and rules of the HGSD and FBSD, as applicable, certain classes of wells, including, among others, wells used to irrigate agricultural crops and certain wells serving users with a total annual water demand of ten million gallons per year or less are exempted from the groundwater reduction requirements of the HGSD and FBSD. The Authority also has the statutory power to impose fees, user fees, or charges for the importation of water into the Authority's boundaries from a source located outside the Authority's boundaries other than a source located in Waller County, Texas that serves a municipality within the Authority. The Authority may also establish and charge rates for water purchased from the Authority. The Authority may establish fees, user fees, rates, and charges that are sufficient to achieve water conservation, prevent waste of water, discourage use of groundwater, implement a groundwater reduction plan, accomplish the purposes of the Act (including providing alternative water supplies), pay maintenance and operating expenses, pay debt service on Authority obligations, and satisfy related rate covenants.

In setting fees, rates, and charges, the Authority is bound by the legal requirement that such rates must be reasonable and to the provision in the Indenture that no free service may be allowed, except to the Authority or as may be authorized by law. Rates for the sale of water to the Retail Utilities and Contract Retail Utilities are subject to the jurisdiction of the Texas Commission on Environmental Quality (the “TCEQ”). Pursuant to Texas law, 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 Authority.

### **Administration**

**Board of Directors.** The Authority is governed by a nine-member board of directors. The Authority’s boundaries are divided into nine director precincts, with each director representing one precinct. Directors are appointed to four-year staggered terms by May 15 in each even-numbered year by the governing bodies of the Retail Utilities that are located and that use water within the applicable precinct. Directors are appointed by vote of the governing bodies of such governmental entities. Votes are weighted in proportion to such entities’ water consumption in the prior calendar year. Vacancies are filled in the same manner. The current members of the board of directors of the Authority, and their terms of office, are as shown inside the cover page. Directors may be compensated up to \$150 per day, not to exceed \$7,200 per year, for their service.

**Consultants.** The Authority currently has no employees, but rather contracts for services as follows:

**Engineers:** The Authority’s consulting engineer is Dannenbaum Engineering Corporation. In addition, specific project design and construction phase engineering services are provided by a number of other engineering and survey firms.

**Bookkeeper:** The Authority has contracted with Myrtle Cruz, Inc. for bookkeeping services.

**Auditor:** The Authority’s financial statements for the fiscal year ended December 31, 2012, were audited by McCall Gibson Swedlund Barfoot PLLC. See Appendix A for a copy of the Authority’s audited financial statements.

**Counsel:** Allen Boone Humphries Robinson LLP serves as general counsel and bond counsel to the Authority.

**Financial Advisor:** RBC Capital Markets, LLC and First Southwest Company serve as the Authority’s co-financial advisors in connection with the issuance of the Bonds.

**Operator:** The Authority has contracted with Severn Trent Environmental Services, Inc. to operate the System.

### **Annexations by the Authority**

The Authority may annex territory within a city or district on petition of the governing body of the city or district, whether or not contiguous, if the Board of Directors determines that the annexation is feasible, practicable, and to the Authority’s advantage. The Authority may also annex territory on petition of the owner(s) of such territory if the Board of Directors determines that the annexation is feasible, practicable and to the Authority’s advantage and that its System is or will be sufficient to supply water to the annexed territory without harming the Authority’s existing territory. If any such territory to be annexed is within the corporate limits or extraterritorial jurisdiction of a municipality, the consent of such municipality must be obtained.

### **Demographic Information**

According to the Texas Municipal Reports, as of December 31, 2012, the total assessed value of the property in the Retail Utilities and Contract Retail Utilities was approximately \$20,962,803,756 and they include over 125,630 water connections. The population of the area within the boundaries of the Authority and Contract Retail Utilities is currently approximately 314,075 people (assuming 2.5 residents per connection).

## **ANNEXATION OF RETAIL UTILITIES BY A CITY**

Under Texas law the unincorporated area within the Authority (including the area within Retail Utilities other than Katy, Texas) may be annexed by a city, if located within the city’s extraterritorial jurisdiction, without the area’s consent. Currently, most of the Authority is located within the extraterritorial jurisdiction of either the City of Houston or the City of Katy. When a city annexes a utility district, it generally must (i) take over all assets of the utility district, (ii) assume all debts, liabilities, and obligations of the utility district, and (iii) perform all functions and services of the utility district. The Act provides that, except to the extent the Authority agrees in writing, no such annexation will affect the Authority’s boundaries, contracts, or powers inside or outside the annexed territory, including the power to assess fees, user fees, rates, charges, and special assessments.

Annexation of territory by a city is a policy-making matter within the discretion of the mayor and city council of such city, and therefore, the Authority makes no representation that either the City of Houston or the City of Katy will ever annex any Retail Utility and assume its obligations. Moreover, no representation is made concerning the ability of either such city to make payments to the Authority should annexation occur.

## **CAPITAL IMPROVEMENT PLANS**

### **Groundwater Reduction Mandate**

Harris County, the county in which the Authority 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 HGSD, established by the Texas Legislature in 1977, regulates the withdrawal of groundwater in Harris County and Galveston County in order to limit land surface subsidence in these counties. With certain limited exceptions, a HGSD permit is required to withdraw groundwater in Harris County. On April 14, 1999, the HGSD adopted a comprehensive plan (the “1999 HGSD Plan”) to reduce groundwater withdrawals. Pursuant to the 1999 HGSD Plan, specific major water users in the Harris County portion of the Authority were required, individually or collectively, to reduce groundwater withdrawals to no more than 70% of their total water use beginning January 2010, to no more than 30% beginning January 2020, and to no more than 20% beginning January 2030. They were also required to submit and obtain HGSD approval of a groundwater reduction plan for meeting these limits.

The FBSD, established by the Texas Legislature in 1989, regulates the withdrawal of groundwater in Fort Bend County in order to limit land surface subsidence in Fort Bend County. With certain limited exceptions, a FBSD permit is required to withdraw groundwater in Fort Bend County. On September 24, 2003, the FBSD adopted a comprehensive plan (as amended to date, the “FBSD Plan”) to reduce groundwater withdrawals. Pursuant to the FBSD Plan, specific major water users in the Fort Bend County portion of the Authority must, individually or collectively, reduce groundwater withdrawals to no more than 70% of their total water use by January 2014 and to no more than 40% by January 2025. There are approximately 6 wells in the Fort Bend County portion of the Authority that are subject to the FBSD conversion requirements and the Authority’s GRP Fee. Following a request from the Authority, the FBSD agreed by Resolution dated June 25, 2008, to allow the Authority to include these 6 wells into the Authority’s HGSD GRP. Under the FBSD’s Resolution, these 6 wells are exempted from FBSD conversion requirements and disincentive fees so long as the Authority is in compliance with its HGSD GRP. In the event the FBSD were to rescind this exemption, the Authority would be required to implement separate groundwater reduction plans for the HGSD and FBSD and comply with the FBSD Plan for these wells.

The Authority obtained HGSD approval of its GRP on April 9, 2003. The Authority’s GRP was submitted on behalf of the Authority, the Retail Utilities and the Private Well Owners that are subject to HGSD groundwater reduction requirements and the Contract Retail Utilities. The GRP projected total water usage within these entities and other areas of the Authority by each of the mandated HGSD conversion dates and established a plan to provide sufficient alternate source water to the area to collectively meet the conversion mandates. See “Projected Capital Expenditures” herein. The plan provided that the Authority would purchase treated surface water from the City of Houston and develop the System, in phases, to transport the water from City of Houston delivery points to certain Retail Utilities, Contract Retail Utilities, and/or Private Well Owners.

The GRP also included a water conservation program that relies primarily on public education to attempt to reduce peak daily demand.

### **Changes to 1999 District Plan**

In 2010, the HGSD began a Regulatory Plan Update Project to (i) update population and water demand projections and (ii) update and recalibrate the parameters in the groundwater models and subsidence models. The updated data and models were then used to evaluate if the regulations in the 1999 District Plan warranted revision. The HGSD’s Update Project used the conversion plans for Regulatory Area 3 contained within certified Groundwater Reduction Plans to more accurately represent where groundwater reductions would likely occur and incorporated the 2010 U.S. Census data to more accurately project population growth. Once projected water demands were determined for the updated population growth, multiple scenarios of groundwater pumpage regulations were tested in the groundwater model and subsidence models. The results from the groundwater model and subsidence models for each scenario of potential regulatory changes were compared back to a baseline scenario that used the regulations from the 1999 District Plan. Considerations of the projected subsidence rates throughout the HGSD were weighed against the feasibility of obtaining alternative water supplies necessary to meet the proposed groundwater reductions.

The HGSD’s Board of Directors adopted an updated regulatory plan (the “2013 Regulatory Plan”) on January 9, 2013. Under the 2013 Regulatory Plan, the Authority is required to: maintain groundwater withdrawals at no more than 70% of total annual water demand under permits issued through 2024; reduce and maintain its groundwater withdrawals to no more than 40% (as opposed to 30%) of total annual water demand beginning with permits issued in 2025 (as opposed to 2020); and reduce and

maintain its groundwater withdrawals to no more than 20% of total annual water demand beginning with permits issued in 2035 (as opposed to 2030).

The estimated water demand within the Authority and the required source of such water under the 2013 Regulatory Plan are as follows. These estimates are based on various assumptions, including assumptions regarding weather patterns and population growth rates. Accordingly, the actual water demand could differ from the current estimates, and the difference could be substantial.

#### PROJECTED WATER DEMAND (SCHEDULE 1)

<b>Year</b>	<b>Actual/Projected Population<sup>(a)</sup></b>	<b>Average Daily Demand (mgd)<sup>(b)(c)</sup></b>		<b>Total GRP Groundwater Maximum Share</b>	<b>Total GRP Minimum Alternate Source Water Demand(mgd)<sup>(e)</sup></b>
		<b>Authority</b>	<b>Total GRP<sup>(d)</sup></b>		
2010	419,172	50.20	55.10	70%	16.56
2025	543,442	79.95	85.67	40%	51.40
2035	609,628	89.74	95.51	20%	76.41

- (a) 2010 is actual calculated population. Estimated and projected population in the Authority based on information obtained from The Center for Public Policy at the University of Houston and the Retail Utilities.
- (b) For the fiscal year ended December 31, 2012, the actual demand of the area within the Authority was 54.47 million gallons per day (“mgd”) and the actual demand of the area covered by the Authority’s GRP was 60.63 mgd; and 65.76% of the demand of the area covered by the Authority’s GRP was provided by ground water and 34.24% was provided by surface water.
- (c) 2010 is actual average daily use. 2025 and 2035 represent projected average daily demand.
- (d) Includes Retail Utilities and Private Well Owners within Authority’s boundaries and Contract Retail Utilities included in GRP.
- (e) 2010 is actual alternate source water used.

Pursuant to the 2013 Regulatory Plan, a permittee (such as the Authority) which has a certified Groundwater Reduction Plan with the HGSD may incorporate any changes resulting from the 2013 Regulatory Plan and resubmit its plan for certification no later than July 1, 2014.

#### **Water Supply Contract**

The Authority entered into a Supply Contract with Houston effective April 8, 2003, for purchase of potable treated surface water. Under the Supply Contract, Houston is responsible for the design, construction, ownership, maintenance and operation of the water facilities that are upstream of the point(s) of delivery to the Authority. The Authority is responsible for the design, construction, ownership, maintenance and operation of its water facilities located downstream of the point(s) of delivery. Under the Supply Contract, Houston will make available to the Authority the amount of water to which the Authority is entitled under the Supply Contract. Subject to the payment obligations below and other provisions of the Supply Contract, the Authority is entitled to take 28.25 million gallons per day (“mgd”), which is estimated by the Authority’s engineer to be sufficient to satisfy the Authority’s water needs through 2024, and the Authority may, but is not obligated to, increase such amount to satisfy its needs through the year 2030.

In accordance with the terms of the Supply Contract, the Authority has paid Houston \$35,376,664 for treatment plant capital costs for the right to receive 28.25 mgd from the City of Houston’s East Water Purification Plant (“*East Plant*”) and \$46,016,695 for transmission facilities capital costs for the right to receive 28.25 mgd through certain transmission facilities that deliver water from the East Plant to a point of delivery, all from proceeds of the Outstanding Bonds. The Supply Contract further provides that if the Authority seeks to purchase more than 28.25 mgd, the additional capital costs for treatment and transmission facilities will be calculated on a pro-rata basis according to the amount of usage rights needed by the Authority in the applicable facility, as more fully set forth by a formula in the Supply Contract.

In accordance with the terms of the Supply Contract, the Authority has paid Houston \$19,933,590.13 for the right to receive 28.25 mgd from Houston’s raw water facilities. Under the Supply Contract, if the Authority seeks to purchase more than 28.25 mgd, and capacity is available in Houston’s existing, as defined in the Supply Contract, raw water facilities (the “*Existing Raw Water Facilities*”), the additional capital costs for raw water facilities will be calculated based on the Authority’s share (as determined by a formula in the Supply Contract) of Houston’s then-outstanding debt for the Existing Raw Water Facilities.

Additionally, if Houston for any reason constructs or acquires new, as defined in the Supply Contract, raw water facilities or rights (collectively, the “*New Raw Water Facilities*”), the Authority is required to pay Houston an annual payment for such New Raw Water Facilities based on the Authority’s share (as determined by a formula in the Supply Contract) of Houston’s annual debt service for such New Raw Water Facilities. The Authority must pay such annual payment for New Raw Water Facilities to Houston irrespective of whether the Authority seeks more than 28.25 mgd or whether the Authority is receiving water from the New Raw Water Facilities; however, the amount of the Authority’s share of such Houston annual debt service is affected by the amount of water rights purchased by the Authority from Houston.

Under the supplement to the Supply Contract effective January 30, 2009 (“*First Supplement*”), Houston has undertaken to finance, design, and construct the Luce Bayou Project (“*Luce Bayou*”) that will deliver approximately 400 million gallons per day of untreated surface water from the Trinity River to Lake Houston in order to increase untreated surface water supplies available to Houston, the Authority, and certain other water authorities receiving surface water from Houston. Houston has entered into a contract with the Coastal Water Authority (“*CWA*”), to construct the Luce Bayou Project.

The First Supplement provides that Houston will issue (or cause CWA to issue) bonds, notes, or other obligations to finance Luce Bayou, except that the Authority’s share of the right-of-way and sites for Luce Bayou will be directly funded by the Authority, as described below.

Since Luce Bayou constitutes a “New Raw Water Facility” under the Supply Contract, the Authority is responsible to pay its share of the annual debt service, as discussed above. For purposes of the cost sharing methodology for Luce Bayou set forth in the Supply Contract, the Authority agreed to increase its reservation for untreated surface water from Houston (referred to in the Supply Contract, as supplemented, as the Authority’s “Untreated Water Facilities Demand Allocation”) to an amount equal to the Authority’s projected water demand for the year 2040, which increased amount is 110.3 mgd. (The First Supplement refers to this increase as the “2008 UWF Reservation.”) Under the First Supplement, the Authority will also pay Houston for its share (as determined by formulas in the Supply Contract) of Existing Untreated Water Facilities based on its 2008 UWF Reservation. The First Supplement also provides that the Authority will pay its share of the total Luce Bayou right-of-way and site costs, which payments have been made in the total amount of \$2,298,577.68. In the event, Houston determines additional money is needed to acquire the necessary right-of-way and sites for Luce Bayou, Houston may make a cash-call to the Authority for its pro rata share (11.10%) of the additional estimated costs, which cash-call is due within 90 days of invoicing by Houston. The 2008 UWF Reservation does not constitute a “Reservation” for “Treated Water Facilities” (generally defined as water plant and transmission facilities) under the Supply Contract. Treated Water Facilities payments will be calculated and made pursuant to the terms of the Supply Contract.

The Supply Contract also provides that the Authority will reimburse Houston on a periodic basis for the expenses incurred by Houston in producing and treating the water delivered to the Authority. Additionally, the Authority is responsible for its share (as calculated under the Supply Contract) of Major Rehabilitations. “Major Rehabilitations” is defined in the Supply Contract as major capital projects required to maintain and operate the East Plant or applicable transmission facilities at their current capacities or as required by applicable regulatory requirements and estimated to cost in excess of \$500,000. The Authority’s share of major rehabilitations is calculated on a pro-rata basis according to the amount of capacity rights of the Authority in the applicable facility.

The Supply Contract provides that the Authority is not guaranteed any specific quantity or pressure of water whenever Houston’s water supply is limited or when Houston’s equipment becomes inoperative due to unforeseen breakdown or scheduled maintenance and repairs. Houston has no liability for failure to furnish any specific amount or pressure of water to the Authority; provided, however, Houston is required to use reasonable efforts to deliver the water required by the Supply Contract and to maintain sufficient pressure at the point(s) of delivery in order for the Authority to receive the water it is entitled to under the Supply Contract.

The term of the Supply Contract is until noon on January 1, 2080. After the expiration of the Supply Contract, the Authority will own the right to use the capacity of the Untreated Water Facilities and Treated Water Facilities (as such terms are defined in the Supply Contract) proportionate to the amount of its Water Demand Allocation (also as defined in the Supply Contract) as it existed immediately prior to such date.

### **Luce Bayou**

The CWA was created by a special act of the Texas Legislature in 1967 with the purpose of providing raw water to Houston and to industry and municipalities in the Counties of Harris, Chambers and Liberty. CWA currently provides raw water to Houston and approximately 100 industrial customers in the region. It also operates and maintains the Lake Houston Dam and pump station and the Trinity River Pump Station and canal system.

The project, with the capacity to convey 450,000 acre feet per year (400 mgd average daily flow) from the Trinity River to Lake Houston will consist of a new 500 mgd pump station located on a 90 acre parcel, approximately 3.05 miles of pipeline, a settling basin and maintenance facility, approximately 23 miles of new canal and an outfall structure at Lake Houston. The preliminary engineering report is complete and right of way acquisition and an environmental impact statement are currently in progress. The project is expected to be in service and delivering water to Lake Houston on or before July 1, 2019. The cost of the project is currently estimated at \$351,400,000.

### **Joint Facilities Agreement**

The Authority entered into a Joint Facilities Agreement effective July 1, 2011, as amended (“*Joint Facilities Agreement*”) with the North Fort Bend Water Authority (“*NFBWA*”). Similar to the Authority, the NFBWA is a water authority

created to reduce use of groundwater and to supply water to certain areas within its groundwater reduction plan, which plan has been certified by the FBSD. The NFBWA is located in northern Fort Bend County and in a small portion of Harris County.

The Joint Facilities Agreement provides that the Authority and NFBWA will share the realty interest acquisition, design, construction, operation and maintenance costs of (i) a pump station and related waterlines constructed, or to be constructed, by the NFBWA near the boundaries of the NFBWA ("*Shared NFBWA Facilities*"), and (ii) approximately 60 miles of major transmission waterlines (collectively, the "*Second Source Line*"), and related pump stations, that will be constructed by the Authority to deliver treated surface water from Houston's Northeast Water Purification Plant to the Authority and NFBWA ("*Shared Authority Facilities*").

Generally, the Joint Facilities Agreement provides that each water authority pays its pro-rata share of (i) capital costs for the applicable facility based on the authority's ownership of water capacity in the facility, and (ii) operation costs based on the authority's usage of the applicable facility. The Authority is responsible to acquire, design, construct, operate and maintain the Shared Authority Facilities. The NFBWA is responsible to acquire, design, construct, operate and maintain the Shared NFBWA Facilities.

To finance a portion of the Shared Authority Facilities, the Authority issued \$41,965,000 of parity bonds for the benefit of the Texas Water Development Board ("*TWDB*") in 2012. Pursuant to Section 10.1 of the Joint Facilities Agreement, the NFBWA is responsible to pay the Authority for the NFBWA's share of the debt service on such bonds (and any other bonds issued by the Authority for the benefit of the TWDB in connection with the Shared Authority Facilities) for each bi-annual debt service payment that is due from the Authority to the TWDB. The NFBWA's share of these debt service payments is 44.9%. The Authority has provided via supplemental indenture that these payments received from the NFBWA under Section 10.1 of the Joint Facilities Agreement are included within "Gross Revenues" for purposes of the Master Indenture.

The Joint Facilities Agreement expires January 1, 2080. After the expiration of the Joint Facilities Agreement, each authority will own the right to use its pro rata share of capacity in the applicable facilities as it existed immediately prior to such date.

### **The Authority's Water System**

The Authority plans to design and build its System in phases as needed to serve the area within the Authority and to achieve compliance with the HGSD Plan and to transport increased quantities of water as they become available for purchase under the Supply Contract.

In the initial phase, which was financed by the Outstanding Bonds and certain Retail Utility advances, the Authority has installed transmission lines to transport water to various Retail Utilities. These improvements, as well as payments previously made to Houston, allow the Authority to deliver approximately 28.25 mgd to such Retail Utilities. Additionally, with proceeds of the Outstanding Bonds, the Authority (i) has installed groundwater storage tanks and booster pumps, and other related facilities, on property acquired by the Authority near Houston's Jersey Village pumping station, generally the location where Houston will deliver the initial water under the Supply Contract; (ii) has paid Houston for the Authority's water treatment and transmission facilities capital cost payments for the Authority's right to receive 28.25 mgd from such facilities; and (iii) has paid Houston for the Authority's raw water facilities capital cost payment for the Authority's right to receive 28.25 mgd from Houston's raw water facilities.

In subsequent phases, the Authority plans to install additional ground storage tanks, pumping stations, and transmission lines to supply additional water to additional Retail Utilities, Contract Retail Utilities, and/or Private Well Owners and to comply with the HGSD's conversion mandates.

Houston has adequate capacity in its East Plant (and in various transmission facilities that connect the plant to Houston's Jersey Village pumping station) and the existing raw water facilities to supply the Authority's projected water demand through 2024, but Houston has informed the Authority that Houston will need to construct additional water treatment capacity and new raw water facilities to supply the Authority's projected 2025 and 2035 needs. Under the Supply Contract, the Authority will be responsible for transporting purchased water from the source of the additional supply.

### **Projected Capital Expenditures**

The Authority has estimated the capital costs required to purchase water capacity and to build or acquire storage tanks, pumps, and transmission lines to supply water and to comply with the HGSD Plan, based on an analysis prepared by the Engineer and assuming the purchase of additional water capacity at Houston's Northeast Water Purification Plant to meet 2025 and 2035 needs. The estimates are preliminary and are derived from the estimates used by the Authority in its GRP, updated to reflect the actual unit prices bid on construction projects undertaken by the Authority to date. The estimates were made without the benefit of detailed plans and specifications. They also do not make any allowance for possible inflation in construction costs, changes in water consumption levels based on population growth, changes in weather trends and other factors, risks and uncertainties that

cannot be predicted, including those factors described under “Investment Considerations” in this Preliminary Official Statement. Accordingly, the actual capital costs of the System could differ from the current estimates, and the difference could be substantial. The capital costs currently estimated by the Authority to purchase treated water and construct or enlarge the System to supply water and meet each conversion mandate in the HGSD Plan are as follows:

**PRELIMINARY ESTIMATE OF REMAINING CAPITAL COSTS (IN 2013 \$s)**

	<b><u>Capital Cost to Meet Conversion Deadline</u></b>		<b><u>Total Remaining</u></b>
	<b><u>2025</u></b>	<b><u>2035</u></b>	<b><u>Capital Cost</u></b>
<b>The System:</b>			
Transmission Lines	\$371,792,000	\$58,800,000	\$430,592,000
Pump Station & Ground Storage	51,036,000	10,000,000	61,036,000
Connections to Retail Utilities	15,000,000	9,000,000	24,000,000
Engineering and Contingencies	<u>175,795,000</u>	<u>28,200,000</u>	<u>203,995,000</u>
<b>Subtotal</b>	613,623,000	106,000,000	719,623,000
<b>Supply Contract</b>			
Untreated Water Capacity	33,686,000	42,485,000	76,171,000
Treatment Plant Capacity	165,196,000	77,158,000	242,354,000
Transmission Main Capacity	<u>0</u>	<u>0</u>	<u>0</u>
<b>Subtotal</b>	<u>198,882,000</u>	<u>119,643,000</u>	<u>318,525,000</u>
<b>Total Costs</b>	<u>\$812,505,000</u>	<u>\$225,643,000</u>	<u>\$1,038,148,000</u>

**Regulation**

Design and construction of the System is subject to the regulatory jurisdiction of federal, state and local authorities, including, among others, the TCEQ, Harris County, and Houston. During construction, the System will be subject to inspection by the TCEQ, Harris County, and Houston.

## FINANCIAL DATA

### Debt Service Schedule

The following schedule sets forth the annual debt service payments on the Outstanding Bonds less the annual debt service on the Refunded Bonds plus the estimated annual principal and interest requirements for the Bonds.

#### Annual Debt Service Requirements (Schedule 2)\*

Year	Outstanding Debt Service	Less Refunded Debt Service	The Bonds			Total Debt Service
			Principal	Interest	Total	
2013	\$25,811,530	(\$1,141,711)		\$882,646	\$882,646	\$25,552,465
2014	25,813,524	(2,283,423)		1,637,900	1,637,900	25,168,001
2015	25,810,524	(2,283,423)		1,637,900	1,637,900	25,165,001
2016	25,808,774	(2,283,423)		1,637,900	1,637,900	25,163,251
2017	25,811,374	(5,638,423)	\$2,665,000	1,637,900	4,302,900	24,475,851
2018	25,808,305	(5,640,673)	2,720,000	1,584,600	4,304,600	24,472,233
2019	25,807,896	(5,639,423)	2,800,000	1,503,000	4,303,000	24,471,474
2020	25,812,804	(5,639,423)	2,915,000	1,391,000	4,306,000	24,479,381
2021	25,812,504	(5,638,483)	3,060,000	1,245,250	4,305,250	24,479,272
2022	25,810,319	(5,640,733)	3,215,000	1,092,250	4,307,250	24,476,837
2023	25,807,799	(5,637,733)	3,370,000	931,500	4,301,500	24,471,567
2024	25,809,070	(5,639,233)	3,540,000	763,000	4,303,000	24,472,838
2025	25,812,066	(5,640,915)	3,720,000	586,000	4,306,000	24,477,151
2026	25,808,023	(5,639,910)	3,905,000	400,000	4,305,000	24,473,113
2027	25,809,315	(5,638,095)	4,095,000	204,750	4,299,750	24,470,970
2028	20,132,552					20,132,552
2029	20,136,400					20,136,400
2030	14,403,569					14,403,569
2031	10,830,454					10,830,454
2032	4,272,250					4,272,250
2033	4,271,500					4,271,500
2034	4,272,000					4,272,000
2035	4,268,250					4,268,250
Total	<u>\$469,740,800</u>	<u>(\$70,025,019)</u>	<u>\$36,005,000</u>	<u>\$17,135,596</u>	<u>\$53,140,596</u>	<u>\$452,856,377</u>

\* Preliminary; subject to change.



## **Rates and Charges**

The Authority has imposed GRP Fees and Water Sale Fees at the following rates since the creation of the Authority:

### **RATES AND CHARGES (SCHEDULE 3)**

<b>GRP Fees</b>		<b>Water Sale Fees</b>	
<b><u>Effective Date</u></b>	<b><u>Rate Per 1,000 Gallons of Water Pumped</u></b>	<b><u>Effective Date</u></b>	<b><u>Rate Per 1,000 Gallons of Water Sold</u></b>
July 1, 2001	\$0.10		
February 1, 2002	\$0.18		
January 1, 2003	\$0.50		
January 1, 2005	No change	January 1, 2005	\$0.80
January 1, 2006	\$0.65	January 1, 2006	\$0.95
January 1, 2007	\$0.75	January 1, 2007	\$1.05
January 1, 2008	\$0.85	January 1, 2008	\$1.15
January 1, 2009	\$0.95	January 1, 2009	\$1.25
January 1, 2010	\$1.25	January 1, 2010	\$1.55
January 1, 2011	\$1.55	January 1, 2011	\$1.85
January 1, 2012	\$1.75	January 1, 2012	\$2.15

To comply with its Rate Covenant as described in this Preliminary Official Statement under “SECURITY AND SOURCE OF PAYMENT—Rate Covenant” and to finance additional capital costs to purchase treated water and construct or enlarge the System, the Authority has determined to increase its GRP Fee to a rate of \$1.90 per 1,000 gallons of water pumped effective July 1, 2013, and the Authority has determined to increase its Water Sale Fee to a rate of \$2.30 per 1,000 gallons of water received effective July 1, 2013.

The Authority anticipates that significant additional increases in its rates and charges beyond the rates for July 1, 2013 will be needed to finance the capital costs to purchase treated water and construct or enlarge the System to meet the 2025 and 2035 conversion deadline as such needs are described in this Preliminary Official Statement under “CAPITAL IMPROVEMENT PLANS — Projected Capital Expenditures.”

The Board of Directors of the Authority currently intends to maintain rates at a level that would result in (i) the approximate cost of producing groundwater plus the GRP Fee being approximately equal to (ii) the Water Sale Fee, all as calculated and estimated by the Authority.

## **Capital Advances from Retail Utilities**

In accordance with the Act, the Authority has adopted a capital advance procedure to provide those Retail Utilities within the boundaries of the Authority with the option to participate in the funding of the Authority’s capital projects. After the Authority has estimated the cost for a capital project, it gives notice to each Retail Utility within its boundaries of that Retail Utility’s pro rata share of such cost (based on their water usage the previous year) and the Retail Utility has a specified amount of time to notify the Authority that it will exercise such option, and an additional specified amount of time to provide funds to the Authority for such capital project. If a Retail Utility exercises this option, it receives a credit against future GRP Fees and/or Water Sale Fees due to the Authority. The credit is determined based on the Authority’s borrowing rate and cost of issuance for its bonds, and is amortized over an approximately 25 year period. The Authority has the statutory power to modify the above procedure if and when the Authority determines to do so.

## **Billing and Collection**

The Retail Utilities, Contract Retail Utilities, and Private Well Owners pay GRP Fees to the Authority monthly based on self-reported quantities of groundwater pumped and any of such entities receiving water from the Authority pay fees for water sales from the Authority on self-reported quantities of water received. Payments are due by the 15<sup>th</sup> day of the second month following the month for which the pumpage or water sales was calculated. Past due amounts are subject to a late penalty of 5%, or if the payment is more than 30 days late, 10%, and also accrue interest at an interest rate set forth in the Authority’s Amended Rate Order until paid.

Pursuant to the Authority's rules, each Retail Utility, Contract Retail Utility, and Private Well Owner is responsible for reading its own meter to measure the amount of groundwater pumped, accurately reporting such measurement to the Authority monthly, keeping its well meter at least 95% accurate, and paying its GRP Fees on or before the due date. The Authority has the right to audit well pumpage, read the well owner's meter, enter the owner's land to audit and/or measure well pumpage, and test and recalibrate, if necessary, the well owner's meter. Pursuant to the Authority's rules, any Retail Utility, Contract Retail Utility, or Private Well Owner receiving water from the Authority is responsible for reading the Authority's water meter to measure the amount of water received by such entity, accurately reporting such measurement to the Authority monthly, and paying its Water Sale Fees on or before the due date. The Authority has the right to audit the water usage, read the Authority's water meter, enter the owner's land to audit and/or measure water usage, and test and recalibrate, if necessary, the Authority's water meter. If a Retail Utility, Contract Retail Utility, or Private Well Owner violates a rule of the Authority, the Authority may impose a civil penalty of not more than \$5,000 for each violation or each day of a continuing violation.

The following table compares groundwater pumpage and surface water usage reported to the HGSD and FBSD to groundwater pumpage and surface water usage reported to the Authority by the Retail Utilities, the Contract Retail Utilities, and Private Well Owners and states the percentage of fees that have been collected for the following years:

**BILLING AND COLLECTION EXPERIENCE (SCHEDULE 4)**

Calendar Year Ending	Groundwater Pumpage and Surface Water Usage Reported to HGSD and FBSD (Gallons)	Groundwater Pumpage and Surface Water Usage Reported to Authority (Gallons)	Percentage of GRP Fees and Water Sale Fees Collected <sup>(a)</sup>
2002	13,327,401,370	13,327,401,370	100.00%
2003	14,842,552,000	14,805,695,176	99.75%
2004	15,045,986,300	15,045,986,300	100.00%
2005	18,136,217,685	18,136,217,685	100.00%
2006	18,484,418,362	18,484,418,362	100.00%
2007	16,586,532,657	16,586,532,657	100.00%
2008	20,311,018,386	20,029,455,957	100.00%
2009	21,565,547,005	21,565,547,005	100.00%
2010	19,842,307,131	19,842,307,131	100.00%
2011	26,139,792,073	25,934,770,473	99.22%
2012	22,131,166,864	22,085,752,181	99.79 <sup>(b)</sup>

<sup>(a)</sup> Except for 2012 (as described in note "b," below), such percentages reflect cumulative total collections for each year through December 31, 2012. The above schedule does not reflect what the collections were at the end of each respective calendar year.

<sup>(b)</sup> As of April 1, 2013, in process of collection. For the year 2013 and subsequent years, it is expected that the HGSD and FBSD will cease requiring the Retail Utilities, Contract Retail Utilities and Private Well Owners to report groundwater usage or surface water usage information to the HGSD or FBSD. The Authority currently intends to implement a procedure by which the Authority will read meters of Retail Utilities, Contract Retail Utilities and Private Well Owners at least once a year in order to verify water usage information that is provided to the Authority by the Retail Utilities, Contract Retail Utilities and Private Well Owners.

## **Principal Water Users**

The 10 Retail Utilities, Contract Retail Utilities and Private Well Owners that used the largest quantities of water and therefore paid the largest amounts of fees for 2012, together with the fees they paid and their respective percentages of total water usage and fees, are as follows:

### **PRINCIPAL RETAIL USERS (SCHEDULE 5)**

<b>12 Months Ended December 31, 2012</b>			
<b>Name</b>	<b>Ground Pumpage and/or Surface Water Usage (gallons)<sup>(a)</sup></b>	<b>GRP and/or Surface Water Fees</b>	<b>Share (%)</b>
Harris County MUD #165	572,779,000	\$1,002,363.25	2.5934%
Harris County MUD #106	510,783,000	893,870.25	2.3127%
Nottingham Country MUD	492,395,000	861,691.25	2.2295%
Mission Bend County MUD #2	479,516,000	839,153.00	2.1712%
Harris County MUD #81	476,140,000	833,245.00	2.1559%
Harris County MUD #120	460,656,000	806,148.00	2.0858%
Harris County MUD #196	438,111,998	783,812.80	1.9837%
City of Katy	437,039,000	764,818.25	1.9788%
Remington MUD #1	436,168,047	929,929.30	1.9749%
Harris County MUD #157	<u>428,982,000</u>	<u>750,718.50</u>	<u>1.9423%</u>
<b>Subtotal</b>	<u>4,732,570,045</u>	<u>\$8,465,749.60<sup>(b)</sup></u>	<u>21.4282%</u>
Top Ten Pumpers	4,732,570,045	\$8,465,749.60	21.4300%
All Other Retail Users	16,246,077,378	31,273,184.78 <sup>(c)</sup>	73.5600%
All Private Well owners	<u>1,107,104,758</u>	<u>1,937,433.33</u>	<u>5.0100%</u>
<b>Total</b>	22,085,752,181	\$41,676,367.70	100.0000%

(a) Based on groundwater pumpage and/or surface water usage data provided to the Authority by the Retail Utilities, Contract Retail Utilities and Private Well Owners.

(b) Includes 459,380,047 gallons of surface water sold by the Authority and the related Water Sale Fees.

(c) Includes 7,054,058,410 gallons of surface water sold by the Authority and the related Water Sale Fees.

## **Summary Revenues and Expenses**

The following table summarizes the Authority's actual revenues and expenses for its fiscal years ended December 31, 2012, 2011 and 2010 and the budgeted revenues and expenses for its fiscal year ending December 31, 2013. The summary for the fiscal year ended December 31, 2012 is derived from and should be read in conjunction with the audited financial statements of the Authority included herein as APPENDIX A.

The budget for fiscal year ending December 31, 2013 has been prepared based on projected population growth, projected water consumption, the estimated cost of operating the System, and other factors, all of which are subject to risks and uncertainties that cannot be predicted, including unexpected expenditures for repairs as well as those factors described under "Investment Considerations" in this Preliminary Official Statement. Accordingly, actual amounts of revenues and expenditures could differ from the budgeted amounts, and the difference could be substantial.

**SUMMARY OF FINANCIAL RESULTS OF OPERATIONS (SCHEDULE 6)**

	Budgeted 2013	2012	2011	2010
<b>Operating Revenues:</b>				
Water Sales	\$18,910,000	\$14,339,019	\$13,071,407	\$9,152,130
Pumpage Fee Revenue	23,377,898	26,674,006	29,584,392	17,879,333
Penalties and Interest	-	-	-	-
Joint Facilities Revenue	101,698	69,366	17,030	-
<b>Total Operating Revenues</b>	<b>\$42,389,596<sup>(a)</sup></b>	<b>\$41,082,391</b>	<b>\$ 42,672,829</b>	<b>\$27,031,463</b>
<b>Operating Expenses:</b>				
Professional Fees	\$1,662,500	\$1,406,385	\$2,351,841	\$1,870,987
Contracted Services	579,400	583,099	540,608	500,904
Purchased Water Service	6,430,948	3,791,177	7,219,470	4,014,852
Utilities	386,000	462,669	476,342	462,085
Repairs and Maintenance	487,000	613,187	498,687	326,064
Depreciation/Amortization <sup>(b)</sup>	-	6,115,065	5,767,254	5,270,938
Other Operating Expenses	748,000	636,492	784,700	522,265
<b>Total Operating Expenses</b>	<b>\$10,293,848</b>	<b>\$13,608,074</b>	<b>\$17,638,902</b>	<b>\$12,968,095</b>
<b>Operating Income (Loss)</b>	<b>\$32,095,748</b>	<b>\$27,474,317</b>	<b>\$ 25,033,927</b>	<b>\$14,063,368</b>
<b>Non-Operating Revenues (Expenses)</b>				
Investment Revenues	\$140,000	\$506,885	\$ 209,517	\$406,021
Capital Contributions	-	899,144	2,182,967	-
Miscellaneous Revenues	50,000	100	2,655	162,063
Bond Issuance Costs	-	(369,500)	-	(6,757)
Interest Expense (Loans and Bonds) <sup>(b)</sup>	(25,811,530)	(12,686,700)	(12,731,353)	(11,166,053)
Chloramine Conversion/Waterline Connections	(1,200,000)	(64,374)	(782,378)	(4,623,839)
Miscellaneous Expenses	-	-	-	(111,945)
Joint Facilities WIF Contribution	1,095,948	473,343	-	-
<b>Total Non-Operating Revenues (Expenses)</b>	<b>\$(25,725,582)</b>	<b>\$(11,241,102)</b>	<b>\$(11,118,592)</b>	<b>\$(15,340,420)</b>
<b>Net Income (Loss)</b>	<b>\$6,370,166</b>	<b>\$16,233,215</b>	<b>\$13,915,335</b>	<b>\$(1,277,052)</b>
<b>Beginning Retained Earnings (As of January 1)</b>	<b>51,959,854</b>	<b>35,726,639</b>	<b>21,811,304</b>	<b>23,088,356</b>
<b>Ending Retained Earnings (As of December 31)</b>	<b>\$58,330,020</b>	<b>\$51,959,854</b>	<b>\$35,726,639</b>	<b>\$21,811,304</b>

(a) Net of \$749,352 for credits due Retail Utilities for capital advances. See "Capital Advances from Retail Utilities."

(b) The Authority does not budget for certain nonoperating revenues and expenses and noncash revenues and expenses. Depreciation/Amortization of Capital Assets, Amortized Prepaid Bond Insurance Costs and Amortized Bond Premiums for 2013 are estimated to be \$(6,115,065), \$(97,690), and \$442,098, respectively. Had these amounts been budgeted, the budgeted Total Operating Expenses would have been \$16,408,913; the budgeted Total Nonoperating Revenues (Expenses) would have been \$(25,381,174); the budgeted Net Income would have been \$599,509; and the budgeted ending Retained Earnings would have been \$52,559,363.

### **Investment Policy**

The Authority maintains an investment strategy that emphasizes, in order of priority, safety, liquidity, and return on investment, as embodied in its investment policy (the “*Investment Policy*”). The Authority does not invest in, among other things, inverse floater, interest-only or principal-only mortgage-backed securities. The Investment Policy provides, among other things, that (i) its bookkeeper or any replacement investment manager must submit quarterly investment reports to the Board of Directors and (ii) the Investment Policy must be reviewed annually by the Board of Directors.

### **Financial Statement**

The Authority’s financial statements for the year ended December 31, 2012, included in APPENDIX A to this Preliminary Official Statement, have been audited by McCall, Gibson Swedlund Barfoot, PLLC, independent certified public accountants, to the extent and for the period indicated in their report thereon. Such financial statements have been included in reliance upon the report of McCall, Gibson Swedlund Barfoot, PLLC. The inclusion in this Preliminary Official Statement of such financial statements, and other financial information in this Preliminary Official Statement, is not intended to imply that any revenues or moneys of the Authority other than the Pledged Revenues and Pledged Funds are pledged to pay the principal of and interest on the Bonds.

## **INVESTMENT CONSIDERATIONS**

### **Dependence on City Facilities**

The Authority’s ability to use alternative water for 30% of its total annual water demand for any given permit year is dependent on the ability of Houston to provide the allotted surface water the Authority has contracted for. The Supply Contract provides that the Authority is not guaranteed any specific quantity or pressure of water whenever Houston’s water supply is limited or when Houston’s equipment becomes inoperative due to unforeseen breakdown or scheduled maintenance and repairs. Houston has no liability for failure to furnish any specific amount or pressure of water to the Authority; provided, however, Houston is required to use reasonable efforts to deliver the water required by the Supply Contract and to maintain sufficient pressure at the point(s) of delivery in order for the Authority to receive the water it is entitled to under the Supply Contract.

According to the HGSD’s regulations, the Authority would be subject to a disincentive fee because if it did not reach the 30% requirement. The Authority’s ability to comply with the HGSD’s mandate is dependent upon its receipt of its allotment of treated surface water from Houston.

### **Need for Additional Surface Water**

To meet the future conversion mandates of the HGSD, the Authority will need an additional untreated water demand allocation and an additional treated water demand allocation. Pursuant to the First Supplement, Houston has agreed to allocate to the Authority an additional 82.05 mgd of untreated surface water by June 30, 2019. In order to do so, Houston plans to transport additional untreated water from the Trinity River via the Luce Bayou Project. In addition, a substantial expansion of the Northeast Plant and the construction of major transmission facilities to the Authority will be necessary to provide the Authority with a sufficient allocation of treated surface water. Failure of Houston to complete the Luce Bayou Project and the expansion of the Northeast Plant, or failure of the Authority to complete the major transmission facilities, on a timely basis will jeopardize the Authority’s ability to meet the future conversion mandates of the HGSD.

### **Subsidence District Disincentive Fees**

To satisfy the HGSD’s 2013 Regulatory Plan to reduce use of groundwater, the Authority must continue to limit the use of groundwater among its participants to no more than 70% of total annual water demand. Compliance is measured annually on the basis of the Authority’s permit year of December 1 through November 30. Compliance with the annual requirement is subject to many factors, many of which are beyond the control of the Authority, including a continued drought in the region or the State. In addition to the Authority’s dependence on Houston facilities and need for additional surface water from Houston, as detailed above, other factors may also affect the Authority’s ability to comply with the conversion mandate. Since one group of Authority participants uses groundwater and another group uses surface water, there can be no assurance that the two groups will use water in the same ratio in the future. Population changes may cause those participants using groundwater to use more water than those using surface water. Moreover, most surface water users also have the ability to pump groundwater from their wells.

In the event the Authority fails to comply with the HGSD’s limits on groundwater use in any compliance period, the Authority would be subject to the payment of a disincentive fee to the HGSD equal to \$7.00 per 1,000 gallons of groundwater withdrawals in Harris County that constitute greater than 20% of the Harris County GRP participants’ total annual water demand and a disincentive fee to the FBSD equal to \$6.50 per 1,000 gallons of groundwater withdrawals in Fort Bend County that constitute greater than 40% of the Fort Bend County GRP participants’ total annual water demand. However, the Authority may have over-conversion credits available to offset the pumpage of groundwater which would otherwise trigger disincentive fees. If

disincentive fees were imposed on the Authority, they could be significant. Treatment of disincentive fees as Operating and Maintenance Expense of the System could decrease Net Revenues pledged to payment of the Bonds, unless GRP Fees and Water Sale Fees were raised commensurately.

### **Modification of Subsidence District Requirements**

On January 9, 2013, the HGSD adopted the 2013 Regulatory Plan, which changed the 1999 District Plan. Incorporation of the requirements of the 2013 Regulatory Plan into the Authority's GRP will require changes to the Authority's capital improvement plans, timing for the issuance of additional bonds, and budget. Future changes to the HGSD requirements could also impact the Authority.

Under the Act, the Authority does not have power to impose GRP Fees on water pumped from wells that meet certain exemptions. If the HGSD or FBSD were to amend their regulatory plans or take other action to exempt additional wells in the Authority, the base from which GRP Fees could be raised would be reduced, and the reduction could be substantial.

### **Additional Debt**

The Authority expects to issue a substantial amount of additional parity debt in the future to be able to build further portions of its delivery system and purchase additional supplies of water. The Indenture provides the requirements for the issuance of additional parity debt. See "SECURITY AND SOURCE OF PAYMENT—Additional Senior Lien Obligations."

While the Authority has the obligation to increase the GRP Fees and Water Sale Fees to take into account increased debt service in the future, there can be no assurance that it will be able to collect the fees and charges necessary to service all of its debt. Continued increases in consumer water rates may ultimately decrease the GRP Fees and Water Sale Fees collected by the Authority, as consumers conserve more water.

### **Project Risks**

To satisfy the HGSD Plan, the Authority must comply with the GRP requirements, including development of the System to transport water from Houston delivery point(s) to Retail Utilities, Contract Retail Utilities, and/or Private Well Owners in phases. To complete each phase of the System in time to comply with the HGSD Plan, the Authority must complete detailed design and seek and obtain design approvals from various governmental agencies, acquire or condemn necessary land, right-of-way and easements, and award and pursue construction contracts, among other actions. See "CAPITAL IMPROVEMENTS PLANS - Proposed Water System." Timely completion of substantial construction projects like the System within budget are subject to a number of risks, including possible delays or inability to secure necessary government approvals or financing, possible escalation or misestimation of construction costs, unanticipated subterranean conditions, unknown environmental hazards, possible adverse weather conditions, possible insolvencies or mistakes of contractors or subcontractors, possible shortages in materials or labor unrest, possible construction period hazards such as flooding or earthquakes, and other factors which cannot be predicted. If the Authority were unable to complete each phase of the System as planned, or were able to do so only at materially higher cost, its financial condition and prospects could be materially adversely impacted. If the Authority were unable to comply with its GRP, the HGSD Plan or future regulations from the HGSD or FBSD, it would be subject to the payment of a disincentive fee to the HGSD equal to \$7.00 per 1000 gallons of groundwater withdrawals in Harris County that constitute greater than 20% of the Harris County GRP participants' total annual water demand and a disincentive fee to the FBSD equal to \$6.50 per 1,000 gallons of groundwater withdrawals in Fort Bend County that constitute greater than 40% of the Fort Bend County GRP participants' total annual water demand, which could further adversely impact the Authority's financial condition.

### **Impact of Weather on Revenue**

The amount of GRP Fees and Water Sale Fees, available to the Authority is directly dependent on the amount of water pumped or purchased by the Retail Utilities, Contract Retail Utilities, and Private Well Owners, which in turn is dependent on the amount of rainfall. The frequency and amount of rainfall experienced within the Authority, especially in summer months, varies significantly from year-to-year. Based on historical experience, during a wet year, the amount of GRP Fees and Water Sale Fees could be as much as 20% less than the amount budgeted by the Authority. Because such a large share of water use occurs in the summer months, the Authority may not be able to adjust its rates to account for larger rainfall months in time to offset lost revenue in the same year.

### **Risk of Catastrophic Loss**

Pursuant to the Supply Contract, the Authority owns the right to receive specified quantities of water from Houston's East Plant and transmission facilities and bears the risk of loss with respect thereto in the event a natural or manmade disaster, such as a hurricane, fire, earthquake, tornado, or war, damages or destroys either. Houston self-insures against such losses and, therefore, there is no third party insurance coverage to provide funds to repair or rebuild the East Plant or transmission facilities,

should they be damaged or destroyed. In the event of a loss, the Authority would be required to contribute to repair and replacement costs to retain its rights to be supplied water, which could result in the issuance of additional Authority bonds without a corresponding increase in water demand. In the event of catastrophic loss to either City of Houston or Authority facilities, there could be a lengthy time period, while the facilities are being repaired or rebuilt, during which the Authority would have to procure another source of treated surface water or permit the Retail Utilities, Contract Retail Utilities, and Private Well Owners to utilize groundwater. Particularly if the Retail Utilities, Contract Retail Utilities, and Private Well Owners do not maintain the operation capabilities of their wells, aggregate consumption and revenue in the period could decrease by a greater amount than expenses. Accordingly, any catastrophic loss of City of Houston or Authority facilities could adversely affect the Authority's ability to pay the Bonds.

The Authority has agreed in the Indenture to insure the portion of its System that is downstream of the point(s) of delivery from Houston's water system and that is owned, controlled and operated by the Authority, to the extent such facilities are customarily insured by political subdivisions of Texas and to the extent such insurance is reasonably available.

### **Regulation of Water Sales**

Rates for sales of water to the Retail Utilities or Contract Retail Utilities on a wholesale basis are subject to the jurisdiction of the TCEQ. As the conversion to surface water is phased in, the amount of revenues derived by the Authority from sales of water to Retail Utilities and Contract Retail Utilities will increase. Any Retail Utility or Contract Retail Utility may appeal to the TCEQ from and within 90 days after any decision by the Authority which affects the amount of water charges owed by them to the Authority. While, under Texas law, the TCEQ may not set a rate for sales of water which is less than the amount required to meet the debt service and bond coverage requirements of the Authority, a successful appeal could result in greater dependence on GRP Fees at a time when fewer of the Retail Utilities and Contract Retail Utilities are paying GRP Fees or could otherwise adversely affect the Authority's ability to pay the Bonds.

### **Limitations on Authority's Remedies**

Remedies available to the Authority in the event of a default by a Retail Utility, Contract Retail Utility, or Private Well Owner in the payment of GRP Fees or Water Sale Fees are limited. See "FINANCIAL DATA – Billing and Collection." The Authority must bring an action in district court to recover the penalties and interest for non-payment or for injunctive relief to prevent violation of Authority rules. In either case, such a remedy would have to be exercised upon each violation and might prove time-consuming, costly and difficult to enforce.

### **Bondholder's Remedies**

The Indenture makes no provision for the acceleration of maturity of any Bonds or operation of the System by the Trustee or 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 Bonds. Statutory language authorizing local governments such as the Authority to sue and be sued does not waive the local government's sovereign immunity from suits for money damages, so that in the absence of other waivers of such immunity by the Texas Legislature, a default by the Authority in its covenants in the Indenture may not be reduced to a judgment for money damages. Moreover, in the event of default, the Trustee has no right or claim under the laws of the State against the System or any property of the Authority other than its right to payment from Pledged Revenues and Pledged Funds maintained pursuant to the Indenture. Accordingly, the only practical remedy in the event of default may be a mandamus or mandatory injunction proceeding to compel the Authority or its officers to increase rates and charges or to perform its other obligations under the Indenture. 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 and groundwater withdrawal by third parties, which is beyond the control of the Authority.

The enforcement of a claim for payment of principal of or interest on any Bonds and the Authority'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.

### **Proposed Legislation**

The 83<sup>rd</sup> Legislature of the State of Texas convened on January 8, 2013 for 140 days. During the session, the Authority is seeking an amendment to the Act that would provide that the Authority may impose GRP Fees on a well or class of wells located in Harris County or Fort Bend County that, on or after February 1, 2013: (1) ceases to be subject to a groundwater reduction requirement imposed by the HGSD or FBSD, as applicable; or (2) is no longer subject to the regulatory provisions, permitting requirements, or jurisdiction of the HGSD or FBSD, as applicable. There can be no assurance that the Authority will attain its legislative goals. The Authority cannot predict the impact on the Authority of legislation enacted during the 83<sup>rd</sup> Legislature.

## **Changes in Legislation**

Certain tax legislation, whether currently proposed or proposed in the future, may directly or indirectly reduce or eliminate the benefit of the exclusion of interest on the Bonds from gross income for federal income tax purposes. Any proposed legislation, whether or not enacted, may also affect the value and liquidity of the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors with respect to any proposed, pending or future legislation.

## **Risk Factor Related to Debt Service Reserve Fund Surety Policies**

The Indenture permits the Authority to purchase debt service reserve fund surety policies to satisfy the Reserve Fund Requirement in lieu of depositing cash in the Debt Service Reserve Fund. While the Indenture requires that a debt service reserve fund surety policy be acquired from a financial institution with a long term credit rating in one of the two highest generic rating categories from at least two nationally recognized rating services or having a credit rating or claims paying ability such that the purchase of the surety policy would not cause any rating agency then rating any Bonds to withdraw or lower its rating on the Bonds, the Indenture does not require the Authority to take any action to replace surety policies when the long term credit ratings of a financial institution providing the policy are lowered.

The Reserve Fund Requirement for the Series 2003 Bonds, the Series 2005 Bonds, the Series 2006 Bonds and the Series 2007 Bonds, which are Parity Bonds with the Bonds, was satisfied by the purchase of surety policies from municipal bond insurance companies. The Authority obtained a debt service reserve fund surety policy from (1) MBIA Insurance Corporation in the amount of \$5,641,472.50 in connection with the issuance of the Series 2003 Bonds, (2) Financial Security Assurance, Inc. in the amount of \$5,748,250 in connection with the issuance of the Series 2005 Bonds, (3) Ambac Assurance Corporation in the amount of \$3,592,711.26 in connection with the issuance of the Series 2006 Bonds, and (4) MBIA Insurance Corporation in the amount of \$4,121,128.74 in connection with the issuance of the Series 2007 Bonds. (See [www.nationalpfg.com](http://www.nationalpfg.com) for information provided by National Public Finance Guarantee Corporation regarding assumption of certain policies from MBIA Insurance Corporation. The Authority makes no representation regarding the accuracy of such information.)

At the time of the issuance of each series of applicable Outstanding Bonds, each surety policy provider was rated “AAA” and “Aaa” by Standard & Poor’s Rating Services (“S&P”) and Moody’s Investor Service (“*Moody’s*”), respectively; however, both S&P and Moody’s have lowered their ratings with respect to each surety policy provider.

Each rating agency establishes its own rating criteria from time to time, and the ratings of any surety policy provider may be changed at any time in the future.

No assurance is given that the debt service reserve fund surety policies will be available to provide timely payment of principal and interest on the Parity Bonds. The obligation of each provider under a debt service reserve fund surety policy is a contractual obligation and in an event of default by the provider, the remedies available may be limited by applicable bankruptcy law or state law related to insolvency of insurance companies. Potential investors should carefully consider the ability of the Authority to pay principal and interest on the Bonds without resort to such debt service reserve fund surety policies.

The Authority is funding \$4,439,708.35\* of the Reserve Fund Requirement with cash from the sale of the Bonds and a transfer of funds from the Improvement Fund and will no longer include the debt service reserve fund surety policy issued by MBIA Insurance Corporation in connection with the Series 2003 Bonds in its Reserve Fund Requirement calculation. Such cash will be available for payment of all the Parity Bonds in the event amounts in the Debt Service Fund are ever insufficient to make principal or interest payments on any Parity Bonds and will not be reserved specifically for principal and interest payments on the Bonds.

## **LITIGATION**

There is no litigation pending against the Authority or in any way contesting the validity of the Bonds.

## **LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS**

Under Texas law, the Bonds are legal and authorized investments for banks, trust companies, building and loan associations, savings and loan associations, insurance companies, fiduciaries or trustees, and for the interest and sinking funds of cities, towns, villages, school districts and other political subdivisions or public agencies of the State of Texas. 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. Most political subdivisions in the State of Texas are required to adopt investment guidelines under the Public Funds Investment Act, Chapter 2256, Texas Government Code, and such political subdivisions may impose other, more stringent requirements in order for the Bonds to be legal investments for such entity’s funds or to be eligible

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\* Preliminary; subject to change.



to serve as collateral for their funds. The Authority has not reviewed the laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

The Authority 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.

## MUNICIPAL BOND RATINGS

Fitch Ratings (“*Fitch*”), Moody’s Investors Service (“*Moody’s*”) and Standard & Poor’s Rating Group (“*Standard & Poor’s*”) have assigned their municipal bond ratings of “A+,” “A1” and “A+,” respectively, to this issue of Bonds. An explanation of the ratings may be obtained from Fitch, One State Street Plaza, New York, NY 10004, Moody’s, 99 Church Street, New York, New York 10007, or Standard & Poor’s, 55 Water Street, New York, New York 10041. The fees associated with the ratings assigned to the Authority and the Bonds by Fitch, Moody’s and Standard & Poor’s will be paid by the Authority; however, the fee associated with ratings provided by other agencies will be at the expense of the Underwriters.

## TAX MATTERS

In the opinion of Allen Boone Humphries Robinson LLP, Bond Counsel, (i) interest on the Bonds is excludable from gross income for federal income tax purposes under existing law, and (ii) interest on the Bonds is not subject to the alternative minimum tax on individuals and corporations, except for certain alternative minimum tax consequences for corporations.

The Internal Revenue Code of 1986 (the “*Code*”) imposes a number of requirements that must be satisfied for interest on state or local obligations, such as the Bonds, to be excludable from gross income for federal income tax purposes. These requirements include limitations on the use of proceeds and the source of repayment, limitations on the investment of proceeds prior to expenditure, a requirement that excess arbitrage earned on the investment of proceeds be paid periodically to the United States and a requirement that the issuer file an information report with the Internal Revenue Service. The Authority has covenanted in the Indenture that they will comply with these requirements.

Bond Counsel’s opinion will assume continuing compliance with the covenants of the Indenture pertaining to those sections of the Code which affect the exclusion from gross income of interest on the Bonds for federal income tax purposes and, in addition, will rely on representations by the Authority, the Authority’s Co-Financial Advisors and the Underwriters with respect to matters solely within the knowledge of the Authority, the Authority’s Co-Financial Advisors and the Underwriters, respectively, which Bond Counsel has not independently verified. The Authority will further rely on the report of Grant Thornton LLP, Certified Public Accountants, regarding the mathematical accuracy of certain computations. If the Authority should fail to comply with the covenants in the Indenture or if the foregoing representations should be determined to be inaccurate or incomplete, interest on the Bonds could become taxable from the date of delivery of the Bonds, regardless of the date on which the event causing such taxability occurs.

The Code also imposes a 20% alternative minimum tax on the “alternative minimum taxable income” of a corporation if the amount of such alternative minimum tax is greater than the amount of the corporation’s regular income tax. Generally, the alternative minimum taxable income of a corporation (other than any S corporation, regulated investment company, REIT, REMIC or FASIT), includes 75% of the amount by which its “adjusted current earnings” exceeds its other “alternative minimum taxable income.” Because interest on tax exempt obligations, such as the Bonds, is included in a corporation’s “adjusted current earnings,” ownership of the Bonds could subject a corporation to alternative minimum tax consequences.

Under the Code, taxpayers are required to report on their returns the amount of tax exempt interest, such as interest on the Bonds, received or accrued during the year. Payments of interest on tax-exempt obligations such as the Bonds are in many cases required to be reported to the IRS. Additionally, backup withholding may apply to any such payments to any owner who is not an “exempt recipient” and who fails to provide certain identifying information. Individuals generally are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients.

Except as stated above, Bond Counsel will express no opinion as to any federal, state or local tax consequences resulting from the ownership of, receipt of interest on, or disposition of, the Bonds.

Prospective purchasers of the Bonds should be aware that the ownership of tax exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be 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 qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the “branch profits tax” on their effectively-connected earnings and profits, including tax exempt interest such as interest on the Bonds. These categories of prospective purchasers should consult their own tax advisors as to the applicability of these consequences.

Bond Counsel's opinions are based on existing law, which is subject to change. Such opinions are further based on Bond Counsel's knowledge of facts as of the date hereof. Bond Counsel assumes no duty to update or supplement its opinions to reflect any facts or circumstances that may thereafter come to Bond Counsel's attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, 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 Bond Counsel's legal judgment based upon its review of existing law and in reliance upon the representations and covenants referenced above that it deems relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given whether or not the Service will commence an audit of the Bonds. If an audit is commenced, in accordance with its current published procedures the Service is likely to treat the Authority as the taxpayer and the owners of the Bonds may not have a right to participate in such audit. Public awareness of any future audit of the Bonds could adversely affect the value and liquidity of the Bonds during the pendency of the audit regardless of the ultimate outcome of the audit.

### **Tax Accounting Treatment of Original Issue Discount Bonds**

The issue price of certain of the Bonds (the "*Original Issue Discount Bonds*") may be less than the stated redemption price at maturity. In such case, under existing law and based upon the assumptions hereinafter stated (a) The difference between (i) the stated amount payable at the maturity of each Original Issue Discount Bond and (ii) the issue price of such Original Issue Discount Bond constitutes original issue discount with respect to such Original Issue Discount Bond in the hands of any owner who has purchased such Original Issue Discount Bond at the initial public offering price in the initial public offering of the Bonds; and (b) Such initial owner is entitled to exclude from gross income (as defined in Section 61 of the Code) an amount of income with respect to such Original Issue Discount Bond equal to that portion of the amount of such original issue discount allocable to the period that such Original Issue Discount Bond continues to be owned by such owner.

In the event of the redemption, sale or other taxable disposition of such Original Issue Discount Bond prior to stated maturity, however, the amount realized by such owner in excess of the basis of such Original Issue 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 Bond was held by such initial owner) is includable in gross income. (Because original issue discount is treated as interest for federal income tax purposes, the discussion regarding interest on the Bonds under the caption "TAX MATTERS" generally applies, except as otherwise provided below, to original issue discount on an Original Issue Discount Bond held by an owner who purchased such Bond at the initial offering price in the initial public offering of the Bonds, and should be considered in connection with the discussion in this portion of the Preliminary Official Statement.)

The foregoing is based on the assumptions that (a) the Underwriters have purchased the Bonds for contemporaneous sale to the general public and not for investment purposes, and (b) all of the Original Issue Discount Bonds have been offered, and a substantial amount of each maturity thereof has been sold, to the general public in arm's-length transactions for a cash price (and with no other consideration being included) equal to the initial offering prices thereof stated on the cover page of this Preliminary Official Statement, and (c) the respective initial offering prices of the Original Issue Discount Bonds to the general public are equal to the fair market value thereof. Neither the Authority nor Bond Counsel warrants that the Original Issue Discount Bonds will be offered and sold in accordance with such assumptions.

Under existing law, the original issue discount on each Original Issue Discount Bond is accrued daily to the stated maturity thereof (in amounts calculated as described below for each six-month period ending on the date before the semiannual anniversary dates of the Bonds and ratably within each such six-month period) and the accrued amount is added to an initial owner's basis for such Bond for purposes of determining the amount of gain or loss recognized by such owner upon redemption, sale or other disposition thereof. The amount to be added to basis for each accrual period is equal to (a) the sum of the issue price plus the amount of original issue discount accrued in prior periods multiplied by the yield to stated maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period) less (b) the amounts payable as current interest during such accrual period on such Bond.

The federal income tax consequences of the purchase, ownership, and redemption, sale or other disposition of Original Issue Discount Bonds which are not purchased in the initial offering at the initial offering price may be determined according to rules which differ from those described above. All owners of Original Issue Discount Bonds should consult their own tax advisors with respect to the determination for federal, state and local income tax purposes of interest accrued upon redemption, sale or other disposition of such Bonds and with respect to the federal, state, local and foreign tax consequences of the purchase, ownership and redemption, sale or other disposition of such Bonds.

### **VERIFICATION OF MATHEMATICAL CALCULATIONS**

Grant Thornton LLP, a firm of independent public accountants, will deliver to the Authority, on or before the settlement date of the Bonds, its verification report indicating that it has verified, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the mathematical accuracy of (i) the mathematical computations of the adequacy of the cash and maturing principal of and interest on the Escrowed Securities held by the Escrow Agent in the Escrow Fund to provide for the payment of the Refunded Bonds; (ii) the mathematical computations of yield used

by Bond Counsel to support their opinion that interest on the Bonds will be excluded from gross income for federal income tax purposes.

The verification performed by Grant Thornton LLP will be solely based upon data, information and documents provided to Grant Thornton LLP by the Authority and its representatives. Grant Thornton LLP has restricted its procedures to recalculating the computations provided by the Authority and its representatives and has not evaluated or examined the assumptions or information used in the computations.

## LEGAL MATTERS

The delivery of the Bonds is subject to the approving opinions of the Attorney General of the State and of Allen Boone Humphries Robinson LLP, Houston, Texas, Bond Counsel for the Authority, as to the validity of the issuance of the Bonds under the Constitution and laws of the State. The opinion of Bond Counsel will be based upon an examination of the transcripts of certain proceedings taken by the Authority incident to the issuance and authorization of the Bonds. Bond Counsel's fees for services rendered with respect to the Bonds are contingent upon the issuance and delivery of the Bonds.

Bond Counsel has reviewed the information appearing on this Preliminary Official Statement under "INTRODUCTION," "PLAN OF FINANCING — Defeasance of Refunded Bonds," "THE BONDS" (except for "— Payment Record"), "SECURITY AND SOURCE OF PAYMENT," "THE AUTHORITY (except for "General," "Administration," and "Demographic Information"), "ANNEXATION OF RETAIL UTILITIES BY A CITY," "CAPITAL IMPROVEMENT PLANS" (but only "Water Supply Contract"), "LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS," "TAX MATTERS," "LEGAL MATTERS," "CONTINUING DISCLOSURE OF INFORMATION (except for "Compliance with Prior Undertakings)," and Appendix C solely to determine whether such information, insofar as it relates to matters of law, is true and correct and whether such information fairly summarizes matters of law and provisions of the documents referred to therein. Bond Counsel has not, however, independently verified any of the factual information contained in this Preliminary Official Statement nor has it conducted an investigation of the affairs of the Authority for the purpose of passing upon the accuracy or completeness of this Preliminary Official Statement. No person is entitled to rely upon Bond Counsel's limited participation as an assumption of responsibility for or an expression of opinion of any kind with regard to the accuracy or completeness of any information contained herein, other than the matters discussed immediately above.

Certain legal matters will be passed upon for the Underwriters by their counsel, Fulbright & Jaworski L.L.P., Houston, Texas.

## FINANCIAL ADVISOR

RBC Capital Markets, LLC and First Southwest Company (collectively, the "*Financial Advisor*") have been retained by the Authority as its independent Financial Advisor in connection with the issuance of the Bonds and, in such capacity, have assisted the Authority in the preparation of documents. The Financial Advisor's fees for services rendered with respect to the Bonds are contingent upon the issuance and delivery of the Bonds.

## UNDERWRITING

Southwest Securities, Inc., BOSC, Inc., The GMS Group, L.L.C., Mesirow Financial Holdings, Inc., Raymond James & Associates, Inc., and Wells Fargo Securities (collectively, the "*Underwriters*"), have agreed to purchase the Bonds at a discount of \$\_\_\_\_\_ from the offering yields shown on the cover page. The Underwriters have agreed to purchase all of the Bonds, if any of the Bonds are purchased. The obligation of the Underwriters is subject to certain conditions.

One of the Underwriters is BOSC, Inc., which is not a bank, and the Bonds are not deposits of any bank and are not insured by the Federal Deposit Insurance Corporation.

Wells Fargo Securities is the trade name for certain securities-related capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association ("*WFBNA*"). WFBNA, one of the Underwriters of the Bonds, has entered into an agreement (the "Distribution Agreement") with its affiliate, Wells Fargo Advisors, LLC ("*WFA*"), for the distribution of certain municipal securities offerings, including the Bonds. Pursuant to the Distribution Agreement, WFBNA will share a portion of its underwriting or remarketing agent compensation, as applicable, with respect to the Bonds with WFA. WFBNA also utilizes the distribution capabilities of its affiliates, Wells Fargo Securities, LLC ("*WFSLLC*") and Wells Fargo Institutional Securities, LLC ("*WFIS*"), for the distribution of municipal securities offerings, including the Bonds. In connection with utilizing the distribution capabilities of WFSLLC, WFBNA pays a portion of WFSLLC's expenses based on its municipal securities transactions. WFBNA, WFSLLC, WFIS, and WFA are each wholly-owned subsidiaries of Wells Fargo & Company.

The prices and other terms on which the Bonds are offered may be changed from time to time by the Underwriters. The Bonds may be offered and sold at prices other than the initial offering prices, including sales to dealers who may sell the Bonds into investment accounts.

## **CONTINUING DISCLOSURE OF INFORMATION**

In the Indenture, the Authority has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The Authority is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the Authority will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to the Municipal Securities Rulemaking Board (the “MSRB”). The MSRB has established the Electronic Municipal Market Access (“EMMA”) System.

### **Annual Reports**

The Authority will provide certain updated financial information and operating data to EMMA annually. The information to be updated includes all quantitative financial information and operating data with respect to the Authority of the general type included on Schedules 1 (footnote b only), 2, 3, 4, 5, and 6 in this Preliminary Official Statement and Appendix A (the Authority’s financial statements). The Authority will update and provide this information within six months after the end of each fiscal year ending on or after December 31, 2013.

The Authority 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 SEC Rule 15c2-12 (the “Rule”). The updated information will include audited financial statements, if the Authority commissions an audit and it is completed by the required time. If audited financial statements are not provided by that time, the Authority will provide audited financial statements when and if they become available and 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 described in Appendix A or such other accounting principles as the Authority may be required to employ from time to time pursuant to state law or regulation.

The Authority’s current fiscal year end is December 31. Accordingly, it must provide updated information by June 30 in each year, unless the Authority changes its fiscal year. If the Authority changes its fiscal year, it will notify EMMA of the change.

### **Material Event Notices**

The Authority will provide timely notices of certain events to EMMA, but in no event will such notices be provided to EMMA in excess of ten days after the occurrence of an event. The Authority will provide notice of any of the following events with respect to the Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701 TEB) or other material notices or determinations with respect to the tax-exempt status of the Bonds, or other events affecting the tax-exempt status of the Bonds; (7) modifications to rights of beneficial owners of the Bonds, if material; (8) bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership or similar event of the Authority or other obligated person within the meaning of the Rule; (13) consummation of a merger, consolidation, or acquisition involving the Authority or other obligated person within the meaning of the Rule or the sale of all or substantially all of the assets of the Authority or other obligated person within the meaning of the Rule, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of an definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of a trustee, if material. The term “material” when used in this paragraph shall have the meaning ascribed to it under federal securities laws. In addition, the Authority will provide timely notice of any failure by the Authority to provide information, data, or financial statements in accordance with its agreement described above under “Annual Reports.”

### **Availability of Information**

The Securities and Exchange Commission (“SEC”) has approved amendments to the Rule, effective July 1, 2009, to designate the MSRB as the sole nationally recognized municipal securities information repository. To make such continuing disclosure information available to investors, the MSRB has established the EMMA system. The Authority is required to file its continuing disclosure information using the Emma system. Investors may access continuing disclosure information filed with the MSRB at [www.emma.msrb.org](http://www.emma.msrb.org).

### **Limitations and Amendments**

The Authority has agreed to update information and to provide notices of material events only as described above. The Authority 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 Authority 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 Authority 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 Authority to comply with its agreement.

The Authority 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 Authority, 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, taking into account any amendments and interpretations of the Rule to the date of such amendment, as well as such changed circumstances, and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or any person unaffiliated with the Authority (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the beneficial owners of the Bonds. The Authority may also amend or repeal its continuing disclosure agreement if the SEC amends or repeals the applicable provisions of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, and the Authority also may amend its continuing disclosure agreement in its discretion in any other manner or circumstance, but in either case only if and to the extent that the continuing disclosure agreement, as amended, would not prevent an underwriter from lawfully purchasing or selling the Bonds in the primary offering of the Bonds. If the Authority 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**

During the last five years, the Authority has complied in all material respects with all continuing disclosure agreements made by it in accordance with SEC Rule 15c2-12.

### **MISCELLANEOUS**

The descriptions herein 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 Indenture or other documents or source they summarize. Statements made herein 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, Indenture, GRP, contracts, 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.

This document was approved by the Board of Directors of the Authority.

**APPENDIX A —**

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY,  
FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012**

# **McCALL GIBSON SWEDLUND BARFOOT PLLC**

*Certified Public Accountants*

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## **INDEPENDENT AUDITOR'S REPORT**

Board of Directors  
West Harris County Regional  
Water Authority  
Harris and Fort Bend Counties, Texas

We have audited the accompanying financial statements of the business-type activities of West Harris County Regional Water Authority (the "Authority"), as of and for the year ended December 31, 2012, and the related notes to financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Member of  
American Institute of Certified Public Accountants  
Texas Society of Certified Public Accountants

Board of Directors  
West Harris County Regional  
Water Authority

## Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2012, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis on pages 3 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The supplementary information required by the Texas Commission on Environmental Quality as published in the *Water District Financial Management Guide* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The supplementary information, excluding that portion marked "Unaudited" on which we express no opinion or provide any assurance, has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



McCall Gibson Swedlund Barfoot PLLC  
Certified Public Accountants

May 8, 2013



# **WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **FOR THE YEAR ENDED DECEMBER 31, 2012**

Management's discussion and analysis of West Harris County Regional Water Authority's (the "Authority") financial performance provides an overview of the Authority's financial activities for the fiscal year ended December 31, 2012. Please read it in conjunction with the Authority's financial statements, which begin on page 10.

#### **USING THIS ANNUAL REPORT**

This annual report consists of a series of financial statements. The basic financial statements include: (1) Statement of Net Position, (2) Statement of Revenues, Expenses and Changes in Net Position, (3) Statement of Cash Flows, and (4) notes to financial statements. This report also includes other supplementary information in addition to the basic financial statements.

#### **IMPLEMENTATION OF NEW ACCOUNTING PRONOUNCEMENTS**

During the current fiscal year, the Authority implemented Governmental Accounting Standards Board (GASB) Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. In the past, financial statement preparers of governmental entities had to consult a variety of resources to determine relevant GAAP in certain circumstances. GASB 62 simplifies this research by codifying relevant FASB and AICPA guidance in one standard. The implementation of GASB 62 has no substantive effect on the Authority's financial statements.

The Authority also implemented GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB 63 adds the new financial statement elements, "deferred inflows of financial resources" and "deferred outflows of financial resources," to the statement of financial position and reports "net position" instead of "net assets." A deferred outflow is the consumption of resources in one period that is applicable to a future period, while a deferred inflow is the acquisition of resources in one period that is applicable to a future period.

The Authority elected to early implement GASB Statement 65, *Items Previously Reported as Assets and Liabilities* in fiscal year 2012. As discussed in the preceding paragraph, GASB 63 added new elements to the statement of financial position; however, guidance was needed to identify which balances should be reported as deferred inflows or deferred outflows. GASB 65 addresses that need and identifies the items to be reported as deferred inflows or outflows. GASB 65 also reclassified bond issuance costs (other than bond insurance) as an expense when incurred. Previously, bond issuance costs were deferred and amortized to expense over the life of the bonds. GASB 65 requires retroactive adoption and, as a result, the Authority has restated beginning net position on the Statement of Net Position for bond issuance costs previously deferred (see Note 3). Comparative data for 2011 has also been restated.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2012**

**FINANCIAL STATEMENTS**

The Authority's annual report includes three financial statements. These financial statements provide both long-term and short-term information about the Authority's overall status. Financial reporting at this level uses a perspective similar to that found in the private sector with its basis in full accrual accounting and elimination or reclassification of internal activities.

The first of the financial statements is the Statement of Net Position located on pages 10 and 11. The Statement of Net Position is the financial statement presenting information that includes all of the Authority's assets, deferred outflows of financial resources, liabilities, and deferred inflows of financial resources with the residual reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Authority as a whole is improving or deteriorating. Evaluation of the overall health of the Authority would extend to other non-financial factors.

The second financial statement is the Statement of Revenues, Expenses and Changes in Net Position located on page 12. This financial statement reports how the Authority's net position changed during the current fiscal year. All current year revenues and expenses are included regardless of when cash is received or paid.

The third financial statement is the Statement of Cash Flows which is located on page 13. The Statement of Cash Flows shows the inflows and outflows of cash that occurred during the current fiscal year.

**NOTES TO FINANCIAL STATEMENTS**

The accompanying notes to financial statements provide information essential to a full understanding of the financial statements. The notes to financial statements can be found on pages 15 through 36 in this report.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**FINANCIAL ANALYSIS**

Net position may serve over time as a useful indicator of the Authority's financial position. In the case of the Authority, assets exceeded liabilities and deferred inflows of resources by \$51,959,854 as of December 31, 2012. A portion of the Authority's net position reflects its investment in capital assets less any debt used to acquire those assets that is still outstanding. The Authority uses these assets to provide water service to its participants. The following table provides a summary of the Authority's net position at December 31, 2012, and December 31, 2011:

	Summary of Changes in the Statement of Net Position		
	2012	2011	Change Positive (Negative)
Current and Other Assets	\$ 148,729,895	\$ 100,294,673	\$ 48,435,222
Capital Assets (Net of Accumulated Depreciation)	259,671,437	249,236,478	10,434,959
Total Assets	<u>\$ 408,401,332</u>	<u>\$ 349,531,151</u>	<u>\$ 58,870,181</u>
Long-Term Liabilities	\$ 320,809,714	\$ 292,636,300	\$ (28,173,414)
Other Liabilities	17,148,679	21,168,212	4,019,533
Total Liabilities	<u>\$ 337,958,393</u>	<u>\$ 313,804,512</u>	<u>\$ (24,153,881)</u>
Total Deferred Inflows of Resources	<u>\$ 18,483,085</u>	<u>\$ -</u>	<u>\$ (18,483,085)</u>
Net Position:			
Net investment in capital assets	\$ (51,580,155)	\$ (22,165,870)	\$ (29,414,285)
Restricted	23,107,819	17,043,098	6,064,721
Unrestricted	80,432,190	40,849,411	39,582,779
Total Net Position	<u>\$ 51,959,854</u>	<u>\$ 35,726,639</u>	<u>\$ 16,233,215</u>

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**FINANCIAL ANALYSIS (Continued)**

The following table provides a summary of the Authority's operations for the fiscal years ending December 31, 2012, and December 31, 2011. The Authority's net position increased by \$16,233,215, resulting in a 45% growth in net position.

	Summary of Changes in the Statement of Revenues, Expenses and Changes in Fund Net Position		
	2012	2011	Change Positive (Negative)
Operating Revenues			
Pumpage Fee Revenues	\$ 26,674,006	\$ 29,584,392	\$ (2,910,386)
Water Service Revenues	14,339,019	13,071,407	1,267,612
Joint Facilities Revenue	69,366	17,030	52,336
Total Operating Revenues	<u>\$ 41,082,391</u>	<u>\$ 42,672,829</u>	<u>\$ (1,590,438)</u>
Operating Expenses	<u>(13,608,074)</u>	<u>(17,638,902)</u>	<u>4,030,828</u>
Operating Income	<u>\$ 27,474,317</u>	<u>\$ 25,033,927</u>	<u>\$ 2,440,390</u>
Nonoperating Revenues (Expenses)			
Investment Revenues	\$ 506,885	\$ 209,517	\$ 297,368
Capital Contributions	899,144	2,182,967	(1,283,823)
Miscellaneous Revenues	100	2,655	(2,555)
Bond Issuance Costs	(369,500)		(369,500)
Interest Expense	(12,686,700)	(12,731,353)	44,653
Chloramine Conversion/ Waterline Connections	(64,374)	(782,378)	718,004
Joint Facilities WIF Contribution	473,343		473,343
Total Nonoperating Revenues (Expenses)	<u>\$ (11,241,102)</u>	<u>\$ (11,118,592)</u>	<u>\$ (122,510)</u>
Change in Net Position	\$ 16,233,215	\$ 13,915,335	\$ 2,317,880
Net Position, Beginning of Year (Restated)	35,726,639	21,811,304	13,915,335
Net Position, End of Year	<u>\$ 51,959,854</u>	<u>\$ 35,726,639</u>	<u>\$ 16,233,215</u>

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**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**CAPITAL ASSETS**

The Authority's investment in capital assets as of December 31, 2012, is \$259,671,438 (net of accumulated depreciation/amortization). This investment in capital assets includes land, easements, water distribution facilities and capital contributions to the City of Houston. Significant capital asset events during the current fiscal year included the following:

Land Additions:

• Land easements	\$ 1,944,873
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Completed Projects:

• Contract 19A - 20" Water Line	\$ 3,467,080
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• Capital Contribution - City of Houston Luce Bayou ROW Costs	\$ 555,000
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Interest in Joint Facilities:

• Bellaire Pump Station Phase 1	\$ 6,201,866
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Construction in Progress:

• Surface Water Transmission Corrosion	\$ 377,848
• Mission Bend Evaluation	148,545
• Second Source Route	2,462,949
• Contract No. 22	4,145,075
• Contract No. 22B	1,374,998
• Contract No. 22C	3,374,296
• Contract No. 22A1	3,720,407
• Contract No. 22A2	3,224,624
• Contract No. 39	56,318
• Contract No. 40	86,092

Total Construction in Progress	\$ 18,971,152
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**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**CAPITAL ASSETS (Continued)**

	2012	2011	Net Increase (Decrease)
Capital Assets Not Subject to Depreciation/Amortization:			
Land and Easements	\$ 16,526,522	\$ 18,488,122	\$ (1,961,600)
Construction in Progress	18,971,152	10,683,475	8,287,677
Capital Assets Subject to Depreciation/Amortization			
Water Distribution System	134,313,663	134,175,213	138,450
Capital Contributions - City of Houston	83,337,230	85,529,201	(2,191,971)
Interest in Joint Facilities	6,522,870	360,467	6,162,403
Total Net Capital Assets	<u>\$ 259,671,437</u>	<u>\$ 249,236,478</u>	<u>\$ 10,434,959</u>

Additional information on the Authority's capital assets can be found in Note 7.

**LONG-TERM DEBT ACTIVITY**

At the end of the current fiscal year, the Authority had total bond debt payable of \$317,180,000. The change in the bonded debt position of the Authority during the fiscal year ended December 31, 2012, is summarized as follows:

Bond Debt Payable - January 1, 2012	\$ 285,710,000
Add: Debt Issuance	41,965,000
Less: Principal Retirement	10,495,000
Bond Debt Payable - December 31, 2012	<u>\$ 317,180,000</u>

In connection with the issuance of the Series 2003, Series 2005, Series 2006, and Series 2007 Bonds (collectively the "Insured Bonds"), the Authority obtained bond insurance from various bond insurers. The Authority did not obtain bond insurance in connection with its Series 2009 and Series 2012 Bonds. Independent of bond insurance, the Authority's Series 2003, Series 2005, Series 2006, Series 2007, and Series 2009 Bonds have a rating of "A+", "A1", and "A+" from Standard & Poor's, Moody's Investor Service, and Fitch Rating respectively. The bond insurers of the Insured Bonds carry higher or lower ratings than the above-described ratings.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**LONG-TERM DEBT ACTIVITY (Continued)**

At the end of the current fiscal year, the Authority owed participants \$8,324,048 for capital contribution credits. See Note 8 for additional information.

The changes in the amount due to participants by the Authority during the fiscal year ended December 31, 2012, are summarized as follows:

Due to Participants-January 1, 2012	\$ 8,624,444
Less: Capital Contribution Credits Applied in the Current Fiscal Year	<u>300,396</u>
Due to Participants-December 31, 2012	<u>\$ 8,324,048</u>

**CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to West Harris County Regional Water Authority, c/o Allen Boone Humphries Robinson, LLP, 3200 Southwest Freeway, Suite 2600, Houston, TX 77027.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**STATEMENT OF NET POSITION**  
**DECEMBER 31, 2012**

**ASSETS**

**CURRENT ASSETS**

Cash, Note 6	\$ 1,852,185
Investments, Note 6	28,594,208
Pumpage Fees Receivable	5,217,212
Joint Facilities Receivable	1,392
Accrued Interest Receivable	16,332
Due From Other Governments	2,233,269
Prepaid Expenses	346,138

**TOTAL CURRENT ASSETS**

\$ 38,260,736

**NONCURRENT ASSETS**

Restricted Cash, Note 6	66,532,199
Restricted Investments, Note 6	22,168,280
Water Conservation Credits, Note 12	1,676,311
Unamortized Prepaid Bond Insurance	1,609,284
Joint Facilities WIF Receivable, Note 13	18,483,085
Capital Assets:	
Land and Easements, Note 7	16,526,522
Construction in Progress, Note 7	18,971,152
Capital Assets (Net of Accumulated Depreciation/Amortization), Note 7	224,173,763

**TOTAL NONCURRENT ASSETS**

\$ 370,140,596

**TOTAL ASSETS**

\$ 408,401,332

**LIABILITIES**

**CURRENT LIABILITIES**

Accounts Payable	\$ 999,582
Accounts Payable-Capital	381,334
Retainage Payable-Capital	833,785
Construction Advances	1,810,232
Accrued Bond Interest Payable	565,689
Joint Facilities Operating Reserve, Note 13	8,585
Due to Participants, Note 8	314,472
Bonds Payable, Due Within One Year, Note 4	12,235,000

**TOTAL CURRENT LIABILITIES**

\$ 17,148,679

**NONCURRENT LIABILITIES**

Due to Participants, Note 8	\$ 8,009,576
Bonds Payable, Due After One Year, Note 4	312,800,138

**TOTAL NONCURRENT LIABILITIES**

\$ 320,809,714

**TOTAL LIABILITIES**

\$ 337,958,393

The accompanying notes to financial  
statements are an integral part of this report.



**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**STATEMENT OF NET POSITION**  
**DECEMBER 31, 2012**

**DEFERRED INFLOWS OF RESOURCES**

Deferred Joint Facilities WIF Revenues	<u>\$ 18,483,085</u>
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**NET POSITION**

Net Investment in Capital Assets	\$ (51,580,155)
Restricted for Debt Service:	
Coverage Fund, Note 5	6,453,381
Reserve Fund, Note 5	6,776,565
Future Debt Service	2,005,084
Restricted for Water Conservation Credits, Note 12	1,676,311
Restricted for Operation and Maintenance Fund	6,196,478
Unrestricted, Including Improvement Fund	<u>80,432,190</u>

**TOTAL NET POSITION**

\$ 51,959,854

**TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION**

\$ 408,401,332

The accompanying notes to financial  
statements are an integral part of this report.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**STATEMENT OF REVENUES, EXPENSES AND**  
**CHANGES IN NET POSITION**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

<b>OPERATING REVENUES</b>	
Pumpage Fee Revenues	\$ 26,674,006
Water Service Revenue	14,339,019
Joint Facilities Revenue	69,366
<b>TOTAL OPERATING REVENUES</b>	<u>\$ 41,082,391</u>
<b>OPERATING EXPENSES</b>	
Professional Fees	\$ 1,406,385
Contracted Services	583,099
Purchased Water Service, Note 11	3,791,177
Utilities	462,669
Repairs and Maintenance	613,187
Depreciation/Amortization	6,115,065
Other	636,492
<b>TOTAL OPERATING EXPENSES</b>	<u>\$ 13,608,074</u>
<b>OPERATING INCOME</b>	<u>\$ 27,474,317</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>	
Investment Revenues	\$ 506,885
Capital Contributions	899,144
Miscellaneous Revenues	100
Bond Issuance Costs	(369,500)
Interest Expense	(12,686,700)
Chloramine Conversion/Waterline Connections	(64,374)
Joint Facilities WIF Contribution, Note 13	473,343
<b>TOTAL NONOPERATING REVENUES (EXPENSES)</b>	<u>\$ (11,241,102)</u>
<b>CHANGE IN NET POSITION</b>	\$ 16,233,215
<b>NET POSITION-JANUARY 1, 2012 (restated)</b>	35,726,639
<b>NET POSITION-DECEMBER 31, 2012</b>	<u><u>\$ 51,959,854</u></u>

The accompanying notes to financial  
statements are an integral part of this report.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2012**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash Received from Participants	\$ 39,264,113
Cash Payments for Goods and Services	(9,501,742)

<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<b><u>\$ 29,762,371</u></b>
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**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Bond Proceeds	\$ 41,965,000
Bond Principal Payments	(10,495,000)
Payment of Bond Interest	(14,317,505)
Bond Issuance Costs	(369,500)
Payments for Capital Assets	(19,116,311)
Payments for Water Trunklines for Participants	(2,233,269)
Joint Facilities WIF Contribution	473,343
Capital Contribution to City of Houston	(555,000)
Capital Contributions Received	899,144
Chloramine Conversion/Waterline Connections	(64,374)
Other Receipts/Expenses	90

<b>NET CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b><u>\$ (3,813,382)</u></b>
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**CASH FLOWS FROM INVESTING ACTIVITIES**

Receipt of Interest	\$ 257,259
Maturity of Investment Securities	1,514,913

<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>	<b><u>\$ 1,772,172</u></b>
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<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>\$ 27,721,161</b>
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<b>CASH AND CASH EQUIVALENTS-JANUARY 1, 2012</b>	<b>\$ 90,225,195</b>
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<b>CASH AND CASH EQUIVALENTS-DECEMBER 31, 2012</b>	<b><u>\$ 117,946,356</u></b>
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**RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:**

Operating Income	\$ 27,474,317
Depreciation/Amortization	6,115,065
Less Capital Contribution Credits Taken	(300,396)
(Increase) Decrease in Pumpage Fees Receivable	(1,519,738)
(Increase) Decrease in Joint Facilities Receivable	1,856
(Increase) Decrease in Water Conservation Credits	(2,555)
(Increase) Decrease in Prepaid Expenses	(76,546)
Increase (Decrease) in Accounts Payable	(200,467)
Increase (Decrease) in Due to Other Governments	(1,729,165)

<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<b><u>\$ 29,762,371</u></b>
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**CASH AND CASH EQUIVALENTS PER STATEMENT OF NET POSITION:**

Cash	\$ 1,852,185
Restricted cash	66,532,199
Investments	28,594,208
Restricted investments (Less US Government Treasury Notes)	20,967,764
<b>Total cash and cash equivalents</b>	<b><u>\$ 117,946,356</u></b>

The accompanying notes to financial  
statements are an integral part of this report.

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**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 1. CREATION OF AUTHORITY**

The West Harris County Regional Water Authority (the "Authority") was created under Article 16, Section 59 of the Texas Constitution by House Bill 1842, as passed by the seventy-seventh (77th) Texas Legislature in 2001, and amended thereafter (the "Act"). The Act empowers the Authority for purposes including the acquisition and provision of surface water and groundwater for residential, commercial, industrial, agricultural, and other uses; the reduction of groundwater withdrawals; the conservation, preservation, protection, recharge, and prevention of waste of groundwater, and of groundwater reservoirs or their subdivisions; and the control of subsidence caused by withdrawal of water from those groundwater reservoirs or their subdivisions.

A nine-member board of directors governs the Authority. The directors serve staggered four year terms. Each director must qualify to serve as director in the manner provided by Section 49.055 of the Water Code and must meet certain other requirements set forth in the Act.

The Authority charges a fee, based on the amount of water pumped from the well, to the owner of wells located within the boundaries of the Authority, unless exempted, and to certain owners of wells located outside the Authority that have contracted with the Authority to be part of the Authority's Groundwater Reduction Plan. The Authority also charges a surface water fee for water sold by the Authority. These fees enable the Authority to fulfill its purposes and regulatory functions, as set forth in the Act.

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board ("GASB"). In addition, the accounting records of the Authority are maintained generally in accordance with the *Water District Financial Management Guide* published by the Texas Commission on Environmental Quality (the "Commission").

GASB has established the criteria for determining whether or not a given entity is a component unit. The criteria are: (1) is the potential component unit a legally separate entity, (2) does the primary government appoint a voting majority of the potential component unit's board, (3) is the primary government able to impose its will on the potential component unit, (4) is there a financial benefit or burden relationship. The Authority was created as an independent governmental entity. The Authority does not meet the criteria for inclusion as a component unit of any entity nor does any other entity meet the component unit criteria for inclusion in the Authority's financial statements.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 2.      SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Financial Statement Presentation

These financial statements have been prepared in accordance with GASB Codification of Governmental Accounting and Financial Reporting Standards Part II. Financial Reporting.

The GASB Codification sets forth standards for external financial reporting for all state and local government entities, which include a requirement for a Statement of Net Position and a Statement of Activities. It requires the classification of net position into three components: Net Investment in Capital Assets; Restricted; and Unrestricted. These classifications are defined as follows:

- Net Investment in Capital Assets - This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets.
- Restricted Net Position - This component of net position consists of external constraints placed on the use of assets imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Position - This component of net position consists of assets that do not meet the definition of "Restricted" or "Net Investment in Capital Assets."

When both restricted and unrestricted resources are available for use, generally it is the Authority's policy to use restricted resources first.

Proprietary Funds - Proprietary Funds are used to account for the Authority's on-going activities, which are similar to those often found in the private sector. The measurement focus is upon determination of net income, financial position, and changes in cash flows. The following is the Authority's Proprietary Fund:

Enterprise Fund - To account for the Authority's costs of providing services, including capital costs (such as depreciation, amortization and capital debt service) which are recovered with fees and charges rather than taxes or similar revenues. Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses are those that result from providing services and delivering goods in connection with the Authority's primary activities. All revenues and expenses not meeting this definition are considered non-operating revenues and expenses.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 2.      SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Basis of Accounting and Measurement Focus

The Enterprise Fund is accounted for on an economic resources measurement focus using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the related liabilities are incurred. Long-lived assets are capitalized and depreciated and all debt is reported in this fund.

Capital Assets

All capital assets, including infrastructure capital assets, are recorded at historical cost. Capital assets (except land, easements and construction in progress) are depreciated or amortized using the straight line method over the following estimated useful lives:

<u>Capital Asset Category</u>	<u>Estimated Life</u>
Water Distribution System	45 years
Interest in Joint Facilities	45 years
Capital Contributions	35-40 years

See Note 7 for additional disclosure.

Interest costs on assets acquired with tax-exempt borrowings are capitalized, net of interest earned on related interest-bearing investments acquired with proceeds of the related borrowings, from the date of borrowing until the assets are ready for their intended use. During the current fiscal year, the Authority incurred interest costs of \$13,927,267 on construction related borrowings and capitalized \$1,259,336 of net interest.

Pension

The Authority has not established a pension plan as the Authority does not have employees. The Internal Revenue Service has determined that fees of office received by Directors are considered to be wages subject to federal income tax withholding for payroll purposes only.

Cash and Cash Equivalents

The Authority considers all amounts in checking accounts, money market accounts, savings accounts, mutual funds, external investment pools and all highly liquid investments with a maturity of ninety days or less when purchased to be cash and cash equivalents. Certificates of deposit are included in cash and cash equivalents regardless of their maturity date. The carrying value of cash and cash equivalents approximates fair value because of the short maturities of these financial instruments. See Note 6 for additional disclosure.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 2.      SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Prepaid Expenses

Certain payments made by the Authority reflect costs applicable to future accounting periods and are recorded as a prepaid expense on the Authority's Statement of Net Position.

Budgeting

In compliance with governmental accounting principles, the Board of Directors annually adopts an unappropriated budget. The budget is then amended during the current fiscal year if need be.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Adopted Accounting Standards

In June 2011, the GASB issued Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB 63 provides guidance on reporting deferred inflows of resources, deferred outflows of resources and net position in a statement of financial position. As a result of the implementation of GASB 63, the Statement of Net Assets has been renamed the Statement of Net Position. This statement has five components: assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Deferred outflows and deferred inflows are the result of the consumption or acquisition, respectively, of net assets in one period that is applicable to future periods. The Authority adopted this statement for the 2012 fiscal year.

In March 2012, the GASB issued Statement 65, *Items Previously Reported as Assets and Liabilities*, which is effective for periods beginning after December 15, 2012; however, the Authority elected to early implement GASB 65 in the current fiscal year. This statement identifies the financial statement items that are to be reported as deferred outflows of resources and deferred inflows of resources. The Authority does not have any deferred outflows of resources. The Authority's deferred inflows of resources consist of deferred revenues related to the Joint Facilities Agreement with the North Fort Bend Water Authority (see Note 13). GASB 65 also requires that bond issuance costs (other than bond insurance) be expensed when incurred. Previous guidance required these costs to be deferred and amortized in a systematic and rational manner. Consequently, beginning net position has been restated (see Note 3).



**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 3. PRIOR PERIOD ADJUSTMENT OF BEGINNING NET POSITION**

As discussed in Note 2, the Authority early implemented GASB 65 during the current fiscal year. Under previous guidance, bond issuance costs were deferred and charged to expense over the life of the bonds. Under GASB 65, these costs (other than bond insurance) are to be expensed as incurred. The unamortized balance of bond issuance costs at the beginning of the 2012 fiscal year was \$4,019,741. GASB 65 requires that any accounting change from the implementation of this standard be applied retroactively by restating beginning net position on the *Statement of Revenues, Expenses and Changes in Net Position*. The effect of restatement on beginning net position is as follows.

Beginning net position, as reported	\$ 39,746,380
Change due to implementation of GASB 65	\$ (4,019,741)
Beginning net position, restated	<u><u>\$ 35,726,639</u></u>

**NOTE 4. BONDS PAYABLE**

	Water System Revenue Bonds Series 2003	Water System Revenue Bonds Series 2005	Water System Revenue Bonds Series 2006	Water System Revenue Bonds Series 2007	Water System Revenue Bonds Series 2009	Water System Revenue Bonds Series 2012
Amount Outstanding - December 31, 2012	\$ 59,330,000	\$ 64,845,000	\$ 42,685,000	\$ 50,580,000	\$ 58,575,000	\$ 41,165,000
Interest Rates	3.60% - 5.00%	3.625% - 5.25%	4.125% - 5.00%	4.00% - 5.00%	4.00% - 5.00%	0.00% - 1.86%
Maturity Dates:						
Beginning - Ending	December 15, 2013, 2016-2024, 2027	December 15, 2013-2029	December 15, 2013-2024, 2026, 2030	December 15, 2013-2027, 2031	December 15, 2013-2019, 2021-2029, 2035	December 15, 2013-2031
Interest Payment Dates	June 15/ December 15	June 15/ December 15	June 15/ December 15	June 15/ December 15	June 15/ December 15	June 15/ December 15
Callable Dates	December 15, 2013*	December 15, 2014*	December 15, 2016*	December 15, 2017*	December 15, 2019*	December 15, 2022*

\*Or any date thereafter, callable at par plus unpaid accrued interest in whole or in part at the option of the Authority. Series 2003 term bonds maturing December 15, 2016, and December 15, 2027, are subject to mandatory redemption beginning December 15, 2014, and December 15, 2025, respectively. Series 2006 term bonds maturing December 15, 2026, and December 15, 2030, are subject to mandatory redemption beginning December 15, 2025, and December 15, 2027, respectively. Series 2007 term bonds maturing December 15, 2031, are subject to mandatory redemption beginning December 15, 2028. Series 2009 term bonds maturing December 15, 2021, and December 15, 2035, are subject to mandatory redemption beginning December 15, 2020, and December 15, 2030, respectively.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2012**

**NOTE 4. BONDS PAYABLE (Continued)**

On March 29, 2012, the Authority issued its \$41,965,000 Series 2012 Water System Revenue Bonds at a net effective interest rate of 1.1917%. The Authority obtained financing for these bonds through the Water Infrastructure Fund (WIF) of the Texas Water Development Board. Proceeds of the bonds will be used to (1) fund costs of design, environmental work, construction and acquisition of realty interests for the Second Source Waterline Project, (2) fund the increase in the reserve fund requirement attributable to the Series 2012 Bonds and (3) pay for the costs of issuance of the Series 2012 Bonds.

The following is a summary of transactions regarding bonds payable for the year ended December 31, 2012:

	January 1 2012	Additions	Retirements	December 31 2012
Bond Debt Payable	\$ 285,710,000			\$ 285,710,000
Bonds Issued		41,965,000		41,965,000
Unamortized Premiums		7,855,138		7,855,138
Principal Retirement			10,495,000	10,495,000
Bond Debt Payable	<u>\$ 285,710,000</u>	<u>\$ 49,820,138</u>	<u>\$ 10,495,000</u>	<u>\$ 325,035,138</u>
				Due Within One Year \$ 12,235,000
				Due After One Year 312,800,138
				<u>Total Bonds Payable \$ 325,035,138</u>

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 4. BONDS PAYABLE (Continued)**

As of December 31, 2012, the debt service requirements on the bonds outstanding were as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 12,235,000	\$ 13,576,530	\$ 25,811,530
2014	12,630,000	13,183,523	25,813,523
2015	13,095,000	12,715,524	25,810,524
2016	13,625,000	12,183,773	25,808,773
2017	14,185,000	11,626,374	25,811,374
2018-2022	80,230,000	48,821,827	129,051,827
2023-2027	99,155,000	29,891,275	129,046,275
2028-2032	60,395,000	9,380,225	69,775,225
2033-2035	11,630,000	1,181,750	12,811,750
	<u>\$ 317,180,000</u>	<u>\$ 152,560,801</u>	<u>\$ 469,740,801</u>

**NOTE 5. INDENTURE OF TRUST AGREEMENT**

The Authority entered into the Indenture of Trust Agreement dated as of August 1, 2003; the First Supplemental Indenture of Trust, dated as of August 1, 2003; the Second Supplemental Indenture of Trust dated as of April 1, 2005; the Third Supplemental Indenture of Trust dated as of August 1, 2006; the Fourth Supplemental Indenture of Trust dated as of October 1, 2007; the Fifth Supplemental Indenture of Trust dated September 1, 2009; and the Sixth Supplemental Indenture of Trust dated March 1, 2012, (collectively, the "Agreement"). Effective November 2, 2005, Regions Bank became the Trustee under the Agreement. (Prior to November 2, 2005, Wachovia Bank, National Association, was the Trustee.) The Agreement was entered into with the Trustee for the purpose of establishing various funds and assigning and pledging the monies held by Trustee to secure the payment of principal and interest on the bonds and payments of certain obligations. The Trustee is responsible for allocating certain available monies of the Authority in accordance with the terms of the Agreement. The following are certain requirements and provisions of the Agreement:

- A. The Authority is required to maintain a Coverage Fund. The Authority is required to establish by each fiscal year end a balance of twenty-five percent (25%) of its maximum annual debt service requirement. The maximum annual debt service requirement is currently \$25,813,523, with 25% being \$6,453,381. These funds are currently invested in a money market mutual fund at the Trustee.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 5.      INDENTURE OF TRUST AGREEMENT (Continued)**

- B. The Agreement also calls for the establishment of a Reserve Fund Requirement. The Reserve Fund Requirement is established and stipulated to be \$25,813,523, which is the lesser of (i) the maximum annual debt service requirement or (ii) 125% of the average annual aggregate debt service requirement. The Reserve Fund Requirement has been satisfied by the Series 2003, 2005, 2006, and 2007 debt service reserve fund surety policies provided by the bond insurers; a deposit of \$4,274,146 from the proceeds of the Series 2009 Bonds; and a deposit of \$2,436,865 from the proceeds of the Series 2012 Bonds. The current Debt Service Reserve balance is \$6,776,565.
- C. In connection with the United States Securities and Exchange Commission Rule 15c2-12, the Authority provides continuing disclosure of certain financial information and operating data to the Municipal Securities Rulemaking Board ("MSRB") via the Electronic Municipal Market Access system established by MSRB. This information, along with the audited annual financial statements, is to be provided within six months after the end of each fiscal year.
- D. The Authority has covenanted that it will take all necessary steps to comply with the requirement that rebatable arbitrage earnings on the investment of the gross proceeds of the bonds, within the meaning of section 148 (f) of the Internal Revenue Code, be rebated to the federal government. The minimum requirement for determination of the rebatable amount is on the 5<sup>th</sup> year anniversary of each issue.

In compliance with this covenant, the 5<sup>th</sup> year arbitrage rebate reports were completed for the Series 2003, 2005, 2006 and 2007 bond issues. The reports reflect that the Authority did not have a rebate obligation to the federal government on these issues.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 6. DEPOSITS AND INVESTMENTS**

Deposits

Custodial credit risk is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits (i.e., cash and certificates of deposit) or will not be able to recover collateral securities that are in the possession of an outside party. The Authority's deposit policy for custodial credit risk requires compliance with the provisions of Texas statutes.

Texas statutes require that any cash balance in any fund shall, to the extent not insured by the Federal Deposit Insurance Corporation or its successor, be continuously secured by a valid pledge to the Authority of securities eligible under the laws of Texas to secure the funds of the Authority, having an aggregate market value, including accrued interest, at all times equal to the uninsured cash balance in the fund to which such securities are pledged. At fiscal year end, the carrying amount of the Authority's deposits was \$69,121,156 and the bank balance was \$69,345,274. Of the bank balance, \$1,483,347 was covered by federal depository insurance, and \$67,861,927 was covered by collateral pledged in the name of the Authority and held in a third-party depository, or letters of credit payable to the Authority.

The carrying values of the deposits at December 31, 2012, are as listed below:

Unrestricted:	
Cash	<u>\$          1,852,185</u>
Restricted:	
Money Market Accounts	66,532,199
Certificates of Deposit	<u>736,772</u>
 TOTAL DEPOSITS	 <u><u>\$         69,121,156</u></u>

For financial statement reporting purposes, the Authority's investments in certificates of deposit are classified with investments on the Statement of Net Position.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 6. DEPOSITS AND INVESTMENTS (Continued)**

Investments

Under Texas law, the Authority is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity and that address investment diversification, yield, maturity, and the quality and capability of investment management, and all Authority funds must be invested in accordance with the following investment objectives: understanding the suitability of the investment to the Authority's financial requirements, first preservation and safety of principal, second; liquidity, third; marketability of the investments if the need arises to liquidate the investment before maturity, fourth; diversification of the investment portfolio, fifth; and yield, sixth. The Authority's investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." No person may invest Authority funds without express written authority from the Board of Directors.

Texas statutes include specifications for and limitations applicable to the Authority and its authority to purchase investments as defined in the Public Funds Investment Act. Authorized investments are summarized as follows: (1) obligations of the United States or its agencies and instrumentalities, (2) direct obligations of the State of Texas or its agencies and instrumentalities, (3) certain collateralized mortgage obligations, (4) other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States (5) certain A rated or higher obligations of states, agencies, counties, cities, and other political subdivisions of any state, (6) bonds issued, assumed or guaranteed by the State of Israel, (7) insured or collateralized certificates of deposit, (8) certain fully collateralized repurchase agreements secured by delivery, (9) certain bankers' acceptances with limitations, (10) commercial paper rated A-1 or P-1 or higher and a maturity of 270 days or less, (11) no-load money market mutual funds and no-load mutual funds with limitations, (12) certain guaranteed investment contracts, (13) certain qualified governmental investment pools and (14) a qualified securities lending program.

The Authority invests in TexSTAR, an external investment pool that is not SEC-registered. First Southwest Asset Management, Inc. and JPMorgan Chase Bank, N.A. manage the daily operations of TexSTAR. The fair value of the Authority's position in the pool is the same as the value of pool shares.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 6. DEPOSITS AND INVESTMENTS (Continued)**

Investments (Continued)

As of December 31, 2012, the Authority had the following investments and maturities:

Investment Type	Fair Values	Maturities in Years		
		Less Than 1	1 -5	6 -10
Restricted - Operations and Maintenance				
TexSTAR	\$ 6,196,478	\$ 6,196,478	\$	\$
Unrestricted - Improvement Fund				
TexSTAR	28,594,208	28,594,208		
Restricted for Debt Service				
Money Market Mutual Funds	14,034,514	14,034,514		
US Government Treasury Notes	1,200,516	1,200,516		
Restricted for Acquisition of Capital Assets				
Certificates of Deposits	736,772	736,772		
<b>TOTAL INVESTMENTS</b>	<b>\$ 50,762,488</b>	<b>\$ 50,762,488</b>	<b>\$ - 0 -</b>	<b>\$ - 0 -</b>

Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At December 31, 2012, the Authority's investments in TexSTAR and Region's money market mutual funds were rated "AAAm" by Standard & Poor's.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Authority considers the investments in TexSTAR and the money market mutual funds to have a maturity of less than one (1) year due to the fact the share positions can usually be redeemed each day at the discretion of the Authority, unless there has been a significant change in value.

The Authority's investment policies do not address investment credit and interest rate risk beyond the rating and maturity restrictions established by state statutes.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 7. CAPITAL ASSETS**

Capital asset activity for the year ended December 31, 2012:

	January 1, 2012	Increases	Decreases	December 31, 2012
<b>Capital Assets Not Being Depreciated/Amortized</b>				
Land and Easements	\$ 18,488,122	\$ 1,944,873	\$ 3,906,473	\$ 16,526,522
Construction in Progress	10,683,475	11,452,852	3,165,175	18,971,152
<b>Total Capital Assets Not Being Depreciated/Amortized</b>	<u>\$ 29,171,597</u>	<u>\$ 13,397,725</u>	<u>\$ 7,071,648</u>	<u>\$ 35,497,674</u>
<b>Capital Assets Subject to Depreciation/Amortization</b>				
Water Distribution System	\$ 143,350,786	\$ 3,467,080	\$	\$ 146,817,866
Capital Contributions - City of Houston	103,181,513	555,000		103,736,513
Interest in Joint Facilities	364,550	6,201,866		6,566,416
<b>Total Capital Assets Subject to Depreciated/Amortization</b>	<u>\$ 246,896,849</u>	<u>\$ 10,223,946</u>	<u>\$ -</u>	<u>\$ 257,120,795</u>
<b>Less Accumulated Depreciated/Amortization</b>				
Water Distribution System	\$ 9,175,573	\$ 3,328,630	\$	\$ 12,504,203
City of Houston Capital Contributions	17,652,312	2,746,971		20,399,283
Interest in Joint Facilities	4,083	39,463		43,546
<b>Total Accumulated Depreciated/Amortization</b>	<u>\$ 26,831,968</u>	<u>\$ 6,115,064</u>	<u>\$ -</u>	<u>\$ 32,947,032</u>
<b>Total Depreciable Capital Assets, Net of Accumulated Depreciated/Amortization</b>	<u>\$ 220,064,881</u>	<u>\$ 4,108,882</u>	<u>\$ -</u>	<u>\$ 224,173,763</u>
<b>Total Capital Assets, Net of Accumulated Depreciation/Amortization</b>	<u><u>\$ 249,236,478</u></u>	<u><u>\$ 17,506,607</u></u>	<u><u>\$ 7,071,648</u></u>	<u><u>\$ 259,671,437</u></u>



**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 8. WATER TRUNKLINE FINANCING AGREEMENT/RESOLUTION  
AUTHORIZING CAPITAL ADVANCE AND REIMBURSEMENT  
PROCEDURE**

On May 6, 2002, and as amended on August 14, 2002, and March 1, 2004, the Authority entered into the Water Trunkline Financing Agreement ("Trunkline Agreement") with Harris County Municipal Utility District No. 130, Harris County Municipal Utility District No. 162, Harris County Municipal Utility District No. 163, Harris County Municipal Utility District No. 179, Harris County Municipal Utility District No. 186, Harris County Municipal Utility District No. 188, Harris County Municipal Utility District No. 208 and Spencer Road Public Utility District (the "Copperfield Districts"). The Copperfield Districts, except No. 130, are referred to herein as the "Participating Copperfield Districts."

Pursuant to the Trunkline Agreement, the Participating Copperfield Districts funded a portion of the costs to design and construct the water distribution trunkline system to deliver water purchased by the Authority from the City of Houston to the Participating Copperfield Districts and other areas. The Authority funded the remainder of the costs to design and construct the trunkline and constructed the trunkline for ownership, operation and maintenance by the Authority as part of its regional surface water distribution system.

Through June 1, 2003, the Participating Copperfield Districts advanced \$5,686,664 to the Authority in accordance with the Trunkline Agreement. With the addition of an interest component and an issuance cost component, the total principal amount of the reimbursement credits to be received by the Participating Copperfield Districts in accordance with the Trunkline Agreement is \$5,788,688. Beginning on June 1, 2003, the Authority initiated the monthly reimbursement credits to each Participating Copperfield District. The reimbursement credits, which include interest, will be provided in 307 equal monthly credits to be applied against all fees, rates and charges due to the Authority for groundwater pumpage and/or surface water purchased. The monthly reimbursement credit received by the Participating Copperfield Districts is \$31,940.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 8. WATER TRUNKLINE FINANCING AGREEMENT/RESOLUTION  
AUTHORIZING CAPITAL ADVANCE AND REIMBURSEMENT  
PROCEDURE (Continued)**

In addition to the Trunkline Agreement, the Authority adopts a Resolution Authorizing Capital Advance and Reimbursement Procedure (collectively, the "Resolution") prior to each new bond issue. The Authority adopts the Resolution pursuant to Section 4.04 of the Act to provide each district and municipality within its boundaries the opportunity to fund its share of the capital costs of the Authority's system and to provide a mechanism for the reimbursement credit thereof. During 2005, and pursuant to the Resolution, the Authority received capital contributions from Mayde Creek Municipal Utility District, West Harris County Municipal Utility District No. 2 and West Park Municipal Utility District in the amount of \$2,148,762. With the addition of an issuance cost component, the total principal amount of the reimbursement credit to be received by these three districts is \$2,168,282. The reimbursement credits, which include interest, to these three districts will be provided in 306 equal credits to be applied against all fees, rates and charges due to the Authority for groundwater pumpage and/or surface water purchased. The monthly reimbursement credit received by these three districts for this capital contribution is \$12,206.

During 2007, the Authority received capital contributions from Harris County Municipal Utility District No. 61 and West Park Municipal District in the amount of \$647,465. With the addition of an issuance cost component, the total principal amount of the reimbursement credit to be received by these two districts is \$664,475. The reimbursement credits, which include interest, to these two districts will be provided in 306 equal monthly credits to be applied against all fees, rates and charges due to the Authority for groundwater pumpage and/or surface water purchased. The monthly reimbursement credit received by these two districts for this capital contribution is \$3,707.

During 2008, and pursuant to the Resolution, the Authority received a capital contribution from West Park Municipal District in the amount of \$392,628. With the addition of an issuance cost component, the total principal amount of the reimbursement credit to be received by this one district is \$396,454. The reimbursement credit, which includes interest, to this one district will be provided in 310 equal monthly credits to be applied against all fees, rates and charges due to the Authority for groundwater pumpage and/or surface water purchased. The monthly reimbursement credit received by this one district for this capital contribution is \$2,222.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 8. WATER TRUNKLINE FINANCING AGREEMENT/RESOLUTION  
AUTHORIZING CAPITAL ADVANCE AND REIMBURSEMENT  
PROCEDURE (Continued)**

During 2010, and pursuant to the Resolution, the Authority received capital contributions from Mayde Creek Municipal Utility District and West Park Municipal District in the amount of \$1,343,665. With the addition of an issuance cost component, the total principal amount of the reimbursement credit to be received by these two districts is \$1,359,219. The reimbursement credits, which include interest, to these two districts will be provided in 310 equal monthly credits to be applied against all fees, rates and charges due to the Authority for groundwater pumpage and/or surface water purchased. The monthly reimbursement credit received by these two districts for this capital contribution is \$7,479.

During the current fiscal year, the interest cost on all the contribution credits was \$390,248. The following is a schedule of the credits and interest to be given by the Authority.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 314,472	\$ 376,156	\$ 690,628
2014	329,227	361,401	690,628
2015	344,673	345,955	690,628
2016	360,845	329,783	690,628
2017	377,776	312,852	690,628
2018-2022	2,171,987	1,281,153	3,453,140
2023-2027	2,731,682	721,458	3,453,140
2028-2032	1,434,040	177,155	1,611,195
2033-2035	259,346	18,118	277,464
	<u>\$ 8,324,048</u>	<u>\$ 3,924,031</u>	<u>\$ 12,248,079</u>
Payable Within			
One Year	<u>\$ 314,472</u>	<u>\$ 376,156</u>	<u>\$ 690,628</u>
Payable After			
One Year	<u>\$ 8,009,576</u>	<u>\$ 3,547,875</u>	<u>\$ 11,557,451</u>

The changes in the amount due to participants by the Authority during the fiscal year ended December 31, 2012, are summarized as follows:

Due to Participants-January 1, 2012	\$ 8,624,444
Less: Capital Contribution Credits Applied in the Current Fiscal Year	<u>300,396</u>
Due to Participants-December 31, 2012	<u>\$ 8,324,048</u>

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 9. WATER TRUNKLINE FINANCING AGREEMENTS WITH HARRIS COUNTY MUNICIPAL UTILITY DISTRICT NOS 418, 433 AND 500**

In 2008, the Authority entered into Water Trunkline Financing Agreements ("Agreements") with Harris County Municipal Utility District No. 418 (HC 418), Harris County Municipal Utility District No. 433 (HC 433) and Harris County Municipal Utility District No. 500 (HC 500), which Agreements with HC 433 and HC 500 were amended in 2011. In connection with the Agreements, these three districts requested that the Authority supply surface water to their water plants prior to the date originally planned by the Authority. In consideration for the early delivery of surface water, each district agreed to finance a portion of the costs to construct the required water trunkline systems. In 2011, HC 418 paid the Authority \$1,569,247 and HC 433 paid \$613,720 pursuant to these Agreements. In 2012, HC 500 paid \$899,144 to the Authority pursuant to these Agreements. These amounts were reported as a Capital Contribution on the Statement of Activities.

**NOTE 10. GROUNDWATER REDUCTION PLAN PARTICIPATION AGREEMENT**

On April 30, 2002, the Authority entered into Groundwater Reduction Plan Participation Agreements with Trail of the Lakes Municipal Utility District, Harris County Municipal Utility District No. 46, Harris County Municipal Utility District No. 106, Harris County Municipal Utility District No. 132, Harris County Municipal Utility District No. 151, Harris County Municipal Utility District No. 152 and Harris County Municipal Utility District No. 180 (the "districts"). The districts are located outside the Authority's boundaries. The Authority agreed to include the districts into the Authority's groundwater reduction plan as non-voting members and the districts agreed to pay the Authority the monthly groundwater pumpage fee.

**NOTE 11. CITY OF HOUSTON**

On April 8, 2003, the Authority entered into a Water Supply Contract (the "Contract") with the City. Under the contract, the Authority purchases potable treated surface water from the City for distribution and use for domestic, commercial and other purposes. The City is responsible for the design, construction, ownership, maintenance and operation of the Untreated Water Facilities and the Treated Water Facilities upstream from the point(s) of delivery. The Authority is responsible for the design, construction, ownership, maintenance and operation of all facilities downstream of the point(s) of delivery. The City will make available to the Authority at the point(s) of delivery the amount of water that equals the Water Demand Allocation, which is currently 28.25 million gallons per day ("mgd").

In 2003, the Authority paid \$51,440,991 for the Treated Water Facilities Capital Contribution for the initial 18.25 mgd Treated Water Facilities Demand Allocation. In addition, prior to December 31, 2009, the Authority paid the City \$12,833,590 for the Untreated Water Facilities Demand Allocation for its initial 18.25 mgd.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 11. CITY OF HOUSTON (Continued)**

The Authority may submit a reservation request to the City for an increase in its Water Facilities Demand Allocation and make appropriate payment for the approved reservation increase. In 2006, the Authority obtained City approval of an additional 10 mgd reservation request and the Authority paid the City an additional \$33,374,275 for the 10 mgd increase in its Treated Water Facilities Demand Allocation to bring the total Treated Water Facilities Demand Allocation to 28.25 mgd. The Authority paid the City \$7,032,104 in April of 2010 for its 10 mgd increase in the Untreated Water Facilities Demand Allocation. In the event the City constructs or acquires New Untreated Water Facilities, the Authority is also responsible to annually pay the City for the Authority's share of the City's annual debt service for the New Untreated Water Facilities.

The Authority is required to reimburse the City on a periodic basis for the expenses incurred by the City in producing and treating the water delivered to the Authority. The City is required to engage an independent auditor on an annual basis to true-up the costs charged to the Authority. During the current fiscal year, the Authority recorded an expense of \$3,791,177 for purchased water, which includes \$118,776 for the final true-up for 2009, 2010, 2011, and the estimated true-up for 2012. The Authority is in the process of evaluating the true-up for 2012.

Effective January 30, 2009, the Authority and the City entered into the First Supplement, as amended January 22, 2013 (the "Supplement") to the Water Supply Contract to increase the supply of untreated surface water available to the Authority, the City and the other authorities through the construction of the Luce Bayou Interbasin Transfer Project ("Luce Bayou"). When completed, Luce Bayou will convey approximately 400 mgd of untreated surface water from the Trinity River to Lake Houston. The Supplement and Water Supply Contract remain in effect until January 1, 2080.

Under the terms of the Supplement, the Authority will make the following payments to the City:

Lump Sum Payments for Right-of-Way Costs. The Authority paid the City a lump sum payment for its share of Luce Bayou rights-of-way costs in three payments as follows: (1) \$1,110,000, which was paid in 2009, (2) \$555,000 was paid in 2010, and (3) \$555,000 was paid in 2012. At the completion of right-of-way acquisition, expected in 2014, a "true-up" will be performed such that the Authority will pay additional funds if it underpaid and will receive a reimbursement if it overpaid.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 11. CITY OF HOUSTON (Continued)**

Payments for Existing Untreated Water Facilities. The Authority seeks to increase its Untreated Water Facilities Demand Allocation from 28.25 mgd to 110.3 mgd, which is currently estimated to be the Authority's surface water demand in the year 2040. Under the terms of the Supplement, the Authority is required to make four (4) payments to the City for Existing Untreated Water Facilities.

Each payment is based on a formula defined in the Supplement based on the Authority's water demand needs in 2025, 2030, 2035 and 2040. The payments are due as follows: (1) the first payment is due at the time Luce Bayou has been completed; (2) the second payment is due upon the earlier of (i) June 30, 2025, or (ii) when the Authority needs its 2030 water demand; (3) the third payment is due upon the earlier of (i) June 30, 2030, or (ii) when the Authority needs its 2035 water demand; and (4) the fourth payment is due upon the earlier of (i) June 30, 2035, or (ii) when the Authority needs its 2040 water demand.

Payment for Phases 1 and 2 Annual New Untreated Water Facilities. Payments made to the City for Phase 1 and 2 Annual New Untreated Water Facilities are to be used only for the purpose of making debt service payments on obligations issued for the construction of Phase 1 and Phase 2 of Luce Bayou. The formulas used to calculate payments are defined in the contract and take into consideration the Authority's 110.3 mgd Untreated Water Facilities Demand Allocation (comprised of the Authority's current 28.25 mgd plus an additional 82.05 mgd upon completion of Luce Bayou), the total amount of untreated water sold by the City to all customers and the City's annual debt service requirement.

**NOTE 12. WATER CONSERVATION CREDITS**

The Authority participates in the Water Wise program sponsored by the Harris Galveston Subsidence District (the "Subsidence District"). The Authority receives a Certificate of Deposit water conservation credit equal to 84,000 gallons of groundwater (which equals 1,400 gallons per month for five years) for each student sponsored. Redemption of the Certificate of Deposit requires the Subsidence District to increase the redeemer's groundwater allocation by the amount of the water conservation credit, provided however that Certificates of Deposit issued beginning with the 2001-2002 school year (Series B) may only be applied to a maximum of thirty percent of the permittee's total water demand. The Authority began purchasing water conservation credits from other entities in 2002. The cost paid to the Subsidence District to sponsor each student and the cost paid to other entities to purchase water conservation credits is recorded as an asset and will be expensed in the year in which the credit(s) are redeemed. The Authority also sells credits to other entities. As of December 31, 2012, the Authority's investment in the water conservation credits is \$1,676,311.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 13. JOINT FACILITIES AGREEMENT**

The Authority and North Fort Bend Water Authority (the “Fort Bend Authority”) entered into a Joint Facilities Agreement dated July 1, 2011, as amended March 1, 2012, (the “Agreement”) to jointly design, acquire, construct, finance, operate and maintain certain (i) booster pump stations and water transmission facilities in the Mission Bend area to receive water from the City of Houston for ultimate delivery to the authorities’ respective customers, and (ii) the Second Source Waterline described below.

Segments 0 & 1A. The Fort Bend Authority is responsible for the design and construction of Segments 0 & 1A. The Authority will pay to the Fort Bend Authority its pro rata share of total project costs which varies depending on the segment. The Fort Bend Authority will own and operate the segments for the benefit of both parties. Each authority will have an equitable interest to the extent of its pro rata share.

Bellaire Pump Station. The Fort Bend Authority is responsible for the purchase of land for the Bellaire Pump Station as well as the design and construction of Phases 1 and 2. In 2011, the Authority paid the Fort Bend Authority \$364,550 for its portion of realty costs associated with the Bellaire Pump Station, which has been added to the Authority’s capital asset schedule.

The Authority will be invoiced for its estimated share of construction costs of Phase 1 based on its current pro-rata share of 8%, plus its share of Phase I facilities that are over-sized for the Authority’s future needs. In 2012, the Authority paid \$6,201,866 to the Fort Bend Authority for its portion of the estimated share of these costs. Upon completion of Phase 1, when the final costs are known, the authorities will adjust the amounts owed between them accordingly. The Fort Bend Authority will own and operate the Bellaire Pump Station for the benefit of both *parties*. Each authority will have an equitable interest to the extent of its pro rata share.

Phase 2 is planned to add capacity to the Bellaire Pump Station for the benefit of the Authority. The Fort Bend Authority will design and construct Phase 2 provided that the Authority pays all Phase 2 project costs. The Fort Bend Authority will invoice the Authority for 100% of Phase 2 design and construction costs.

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
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**NOTE 13. JOINT FACILITIES AGREEMENT (Continued)**

Second Source Waterline. The Second Source Waterline consists of water mains, pump stations, re-pump stations, re-pressurization stations and related appurtenances needed to convey water from the City's Northeast Water Plant to the authorities. The Second Source Waterline is required to be completed no later than June 30, 2024. The Authority will own and operate the Second Source Waterline for the benefit of both parties. Each authority will have an equitable interest to the extent of its pro rata share.

The Authority will invoice itself and the Fort Bend Authority for each authority's respective pro-rata share of realty acquisition costs, engineering costs, and construction costs, which invoices are required to be paid pursuant to the terms of the Agreement. All deposits are to be deposited into a separate bank account and the bookkeeper will provide monthly reports of the application of each authority's payment for project costs and of related interest earnings.

The responsible authority, which means the Fort Bend Authority for Segment 0, Segment 1A, and the Bellaire Pump Station and the Authority for the Second Source Waterline, will maintain, repair and operate the joint facilities for which it is responsible. Prior to the joint facilities going into service, each Authority will pay their respective shares of operation and maintenance expenses which will be allocated based on the authorities' pro-rata share of the applicable joint facility. After the facilities go into service, each authority will pay a fraction of the monthly operation and maintenance expenses based on the amount of water received.

Each authority is required to establish a separate joint facilities account. All funds received and any expenses related to the joint facilities shall be accounted for through this account. Each month, the responsible authority will provide a bill to each authority for its respective share of the actual expenses made from the joint facilities account. Additionally, an initial deposit of one fourth of the annual budget prepared for the joint facilities account will be billed. The authorities will establish a capital replacement account for each joint facility, and the amount and timing of funding of this account will be mutually agreed upon.

As required by the Agreement, the Authority established the Second Source Waterline fund to account for project costs associated with the Second Source Waterline. In 2011, the Fort Bend Authority deposited \$5,975,887 into this account for its portion of the estimated Second Source Waterline realty costs. As of December 31, 2012, the remaining balance from this advance is \$1,810,232, which is recorded as a construction advance.



**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 13. JOINT FACILITIES AGREEMENT (Continued)**

Additionally, the Fort Bend Authority and the Authority deposited \$8,585 and \$12,665 respectively into the joint facilities account for its portion of the operating reserve. The Fort Bend Authority was also billed \$69,366 for its share of operation and maintenance expenses related to the joint facilities during the current year.

Water Improvement Fund Bonds. The Authority is authorized to issue bonds financed through the Water Improvement Fund (WIF) of the Texas Water Development Board (TWDB) to fund a portion of the Second Source Waterline project costs. Debt service requirements for these bonds will be shared between the Authority and the Fort Bend Authority on a pro-rata basis. The Fort Bend Authority is required to make two payments to the Authority each year equal to the Fort Bend Authority's pro-rata share of the annual debt service on the bonds. During the current year, the Authority issued its \$41,965,000 Series 2012 Water System Revenue Bonds to the TWDB related to this Agreement. The Fort Bend Authority's pro-rata share of these bonds is \$18,842,285, which was recorded as an asset and a deferred inflow of resources on the Statement of Net Position. During the current year, the Fort Bend Authority paid the Authority \$473,343 for its pro-rata share of the annual debt service payment, which consists of a principal reduction of \$359,200 and an interest component of \$114,143. As of December 31, 2012, the outstanding balance of the receivable and deferred inflow is \$18,483,085.

The Fort Bend Authority's share of the debt service requirements on the WIF bonds is as follows:

<i>Fiscal Year</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2013	936,165	157,987	1,094,152
2014	936,165	157,987	1,094,152
2015	936,165	157,987	1,094,152
2016	936,165	157,987	1,094,152
2017	936,165	157,987	1,094,152
2018-2022	4,710,010	760,058	5,470,068
2023-2027	4,907,570	561,834	5,469,404
2028-2031	<u>4,184,680</u>	<u>187,926</u>	<u>4,372,606</u>
	<u>\$ 18,483,085</u>	<u>\$ 2,299,753</u>	<u>\$ 20,782,838</u>

**WEST HARRIS COUNTY REGIONAL WATER AUTHORITY**  
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**NOTE 14. RISK MANAGEMENT**

The Authority is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the Authority carries commercial insurance. There were no significant reductions in insurance coverage from the prior year and settlements have not exceeded coverage in the past three years.

**APPENDIX B —  
LIST OF RETAIL UTILITIES AND CONTRACT RETAIL  
UTILITIES WHO OWN WATER WELLS**

Retail Utilities

Addicks UD	HC MUD 257
Barker-Cypress MUD	HC MUD 264
Beechnut MUD	HC MUD 276
Bissonnet MUD	HC MUD 284
Castlewood MUD	HC MUD 341
Chelford City MUD	HC MUD 370
Chelford One MUD	HC MUD 371
Cimarron MUD	HC MUD 374
Clay Road MUD	HC MUD 405
Fry Road MUD	HC MUD 418
HC MUD 061	HC MUD 432
HC MUD 063	HC MUD 433
HC MUD 064	HC MUD 434
HC MUD 070	HC UD 6
HC MUD 071	HC FBC MUD 3
HC MUD 081	HC WCID 157
HC MUD 102	Horsepen Bayou MUD
HC MUD 105	Interstate MUD
HC MUD 120	Jackrabbit Road PUD
HC MUD 127	Langham Creek UD
HC MUD 130	Mayde Creek MUD
HC MUD 136	Memorial MUD
HC MUD 144	Mission Bend MUD 1
HC MUD 147	Mission Bend MUD 2
HC MUD 149	Morton Road MUD
HC MUD 155	Nottingham Country MUD
HC MUD 157	NW HC MUD 12
HC MUD 162	Remington MUD 1
HC MUD 163	Renn Road MUD
HC MUD 165	Ricewood MUD
HC MUD 167	Rolling Creek UD
HC MUD 172	Spencer Road PUD
HC MUD 173	W HC MUD 02
HC MUD 179	W HC MUD 04
HC MUD 183	W HC MUD 07
HC MUD 185	W HC MUD 15
HC MUD 186	W HC MUD 17
HC MUD 188	West Memorial MUD
HC MUD 196	West Park MUD
HC MUD 208	Westlake MUD 1
HC MUD 238	Weston MUD
HC MUD 239	City of Katy
HC MUD 250	

Contract Retail Utilities

HC MUD 046	HC MUD 151
HC MUD 106	HC MUD 152
HC MUD 132	HC MUD 180
	Trail of the Lakes MUD

## APPENDIX C —

### EXCERPTS OF CERTAIN PROVISIONS OF THE INDENTURE OF TRUST

The following are selected provisions of the Indenture of Trust dated as of August 1, 2003, as amended (“*Master Indenture*”). These excerpts should be qualified by reference to other portions of the Master Indenture referred to elsewhere in this Preliminary Official Statement, and all references and summaries pertaining to the Master Indenture in this Preliminary Official Statement are qualified by reference to the exact terms of the Master Indenture, a copy of which may be obtained from the Trustee. Any references to Sections listed below are to the Master Indenture. Section and Article references contained in the following excerpts are to Sections and Articles contained in the Master Indenture. Provisions included herein may be amended in accordance with the terms of the Master Indenture.

\* \* \*

### INDENTURE OF TRUST

THIS INDENTURE OF TRUST, dated as of the 1st day of August, 2003, is made by and between WEST HARRIS COUNTY REGIONAL WATER AUTHORITY, a political subdivision of the State of Texas (the “Authority”), and REGIONS BANK, Houston, Texas (as successor trustee and together with any other successor trustee hereunder, the “Trustee”).

\* \* \*

NOW, THEREFORE, in consideration of the premises, the acceptance by the Trustee of the trusts hereby created, the purchase and acceptance of the Bonds and Notes by the Owners thereof, the execution and delivery of the Obligations by the other parties thereto and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Authority and the Trustee do hereby mutually covenant and agree, for the equal and proportionate benefit (except as herein provided) of the respective Owners from time to time of the Bonds, and Notes and the other parties to the Obligations as follows:

\* \* \*

Section 101. Definitions. For all purposes of this Indenture the following terms shall have the meanings set forth below unless the contexts or use clearly indicates otherwise:

“Account” or “Accounts” shall mean any one or more, as the case may be, of the accounts from time to time hereafter created in any of the Funds required to be maintained pursuant to Section 502.

“Act” shall mean Act of May 28, 2001, 77th Legislature, Regular Session, Chapter 414, 2001 Tex. Gen. Laws, as amended.

“Aggregate Debt Service” for any Fiscal Year or other period shall mean, as of the date of calculation, the sum of the amounts of Debt Service for such Fiscal Year or other period with respect to such Bonds, Notes, and Obligations of any one or more Series of Bonds, Notes and other Obligations then outstanding.

\* \* \*

“Bonds” shall mean the Parity Bonds and Junior Lien Bonds.

\* \* \*

“Business Day” shall mean a day which is not a banking holiday in New York City, New York or Houston, Texas, except as may otherwise be provided by Supplemental Indenture.

\* \* \*

“Construction Fund” shall mean the Construction Fund established pursuant to Section 502.

“Contract Obligations” means capitalized lease obligations, installment purchase agreements, purchase contracts or other contract agreements to acquire, purchase, improve or install the System (other than goods and services that are acquired in the ordinary course of business) that are shown on the liability side of the balance sheet under generally accepted accounting principles. Contract Obligations may be incurred as Parity Obligations or Junior Lien Obligations.

\* \* \*

“Coverage Fund” shall mean the Coverage Fund established pursuant to Section 502.

“Coverage Fund Requirement” shall mean, for Parity Bonds, Notes and Obligations, 25% of their Maximum Annual Debt Service Requirements.

“Credit Agreement” shall mean any agreement between the Authority and a third party pursuant to which such third party issues a letter of credit, municipal bond insurance policy, line of credit, standby purchase agreement, Debt Service Reserve Fund Surety Policy, surety bond, or other guarantee for the purpose of enhancing the creditworthiness or liquidity of any of the Authority’s obligations pursuant to any Bonds, Notes, Hedge Agreements or Contract Obligations and shall include, to the extent permitted by applicable law, Investment Liquidity Facilities; and in consideration for which the Authority may agree to pay certain fees and to reimburse and repay any amounts advanced under such Credit Agreement, together with interest and other stipulated costs and charges. Credit Agreements include, without limitation, Parity Credit Agreements and Junior Lien Credit Agreements.

“Debt Service” shall mean, with respect to any particular Fiscal Year or other period and any Series of Bonds, Notes or other Obligations, an amount equal to the sum of (a) all interest payable on such Bonds and Notes during such period, except to the extent that such interest is to be paid from amounts (including any investment earnings thereon) deposited in the Debt Service Fund, Debt Service Reserve Fund, Junior Lien Debt Service Fund, Junior Lien Debt Service Reserve Fund, Construction Fund, or elsewhere for the purpose of providing capitalized interest, plus (b) that portion of the principal amount of such Bonds or Notes which are due and payable during such period at maturity or pursuant to mandatory sinking fund redemption, (c) plus net amounts payable and minus net amounts receivable by the Authority under any Hedge Agreements during such period (excluding termination payments); provided, however, for purposes of satisfying the requirements in Article III (with respect to the issuance of Bonds and Notes and incurring Obligations) and determining the Reserve Fund Requirement, the following rules shall apply whenever a calculation of Debt Service is required:

(A) Interest and principal for any Series of Bonds or Notes shall be calculated on the assumption that no Bonds or Notes of any Series Outstanding on the date of calculation will cease to be Outstanding except by reason of the scheduled payment of principal on the due date thereof.

(B) Interest and principal for any Series of Notes shall be calculated on the assumption that all such Notes shall be continuously refinanced with other Notes or Bonds, bearing interest as provided in (C) below, so as to permit approximately equal annual amortization of Debt Service on such Series of Notes to be due and payable over a period of twenty-five (25) years following the date of such calculation.

(C) Except as provided in (D) below, future Debt Service for any Series of Bonds or Notes which bears interest at variable rates or which will at some future date bear interest at a rate or rates to be determined or which will be subject to conversion to an interest rate or interest rate mode such that rates cannot then be ascertained shall be deemed to bear interest at a rate which shall be estimated and certified by the Financial Advisor to the Authority as the rate that would have been borne by a Series of Bonds if (i) they were secured by the same lien on Pledged Revenues, (ii) they were issued (or remarketed as the case may be) at the date of certification and (iii) they were to bear a fixed rate of interest with a 25 year maturity from such date of certification.

(D) Amounts payable and/or receivable by the Authority under Hedge Agreements may be combined with payments of Debt Service on any Series of Bonds or Notes to which the Hedge Agreement relates. In such event, the Financial Advisor to the Authority shall prepare a combined calculation of Debt Service with respect to the amounts payable and/or receivable under the Hedge Agreement and the amounts of interest payable under the Bonds or Notes to which it relates, and in such calculation may offset amounts receivable by the Authority under the Hedge Agreement against interest payable on related Bonds or Notes. Any remaining (i.e. not offset) payment obligations of the Authority under the Hedge Agreement shall be treated as payments of interest for purposes of computing Debt Service and shall be calculated at the rate provided in such Hedge Agreement the same as if it were an interest rate on Bonds or Notes, and if such rate is variable or otherwise not ascertainable at the time of calculation, shall be estimated by the Financial Advisor to the Authority in the same manner as herein provided for the estimation of Debt Service on Bonds or Notes bearing interest at variable rates or rates not ascertainable at the time of calculation. If not combined with payments of Debt Service on Bonds or Notes as set forth above, amounts payable and/or receivable by the Authority under Hedge Agreements shall include only the net amount payable and/or receivable for purposes of computing Debt Service.

(E) Interest accruing on Bonds or Notes issued as capital appreciation bonds or capital appreciation notes shall be treated as principal payable at maturity of such Bonds or Notes.

(F) Interest (other than on capital appreciation bonds or notes) shall be deemed to accrue monthly and principal also shall be deemed to accrue monthly but only during the twelve months immediately preceding any scheduled principal payment (or during such shorter periods as may be appropriate if principal payments are more frequent than every twelve months).

(G) Credit Agreements shall not be deemed to impose any additional Debt Service by reason of the repayment or reimbursement obligations that they impose, but any periodic payments they require for the continued availability of the Credit Agreement shall be included within the computation of Debt Service.

“Debt Service Expenses” shall mean the ongoing fees and expenses of the Authority relating to its Bonds, Notes, and other Obligations, including its fees and expenses relating to: (1) the Trustee, Paying Agents, Registrars, Authenticating Agents, securities dealers, Securities Depositories, or other Fiduciaries; (2) tax rebate, financial and legal consultants; (3) insurers; (4) remarketing, indexing, or similar agreements; (5) to the extent not included within the definition of Debt Service, Credit Agreements, Hedge Agreements, Investment Liquidity Facility agreements, or Reserve Fund Surety Policies.

“Debt Service Fund” shall mean the Debt Service Fund established pursuant to Section 502.

“Debt Service Reserve Fund” shall mean the Debt Service Reserve Fund established pursuant to Section 502.

“Debt Service Reserve Fund Surety Policy” shall mean any reserve fund surety policy or bond, letter of credit or other instrument, however denominated, provided by a qualifying financial institution as described in the following sentence, pursuant to which the Trustee or Paying Agent may draw on such Debt Service Reserve Fund Surety Policy to enable either the Debt Service Reserve Fund or the Junior Lien Debt Service Reserve Fund to make a required transfer to the Debt Service Fund or Junior Lien Debt Service Fund. Debt Service Reserve Fund Surety Policies may only be acquired from a financial institution with a long term credit rating in one of the two highest generic rating categories from at least two nationally recognized rating services or having a credit rating or claims paying ability such that the purchase of such surety policy will not cause any rating agency then rating any Bonds or Notes to withdraw or lower its rating. Each Debt Service Reserve Fund Surety Policy shall be payable on demand of the Trustee or Paying Agent for the benefit of the Owners of the Bonds, Notes, or other Obligations payable from such Funds.

\* \* \*

“Fiscal Year” shall mean a fiscal year as established by the Authority which is currently the 12-month period ending the last day of December but which may be changed from time to time.

“Fund” or “Funds” shall mean any one or more, as the case may be, of the separate special funds created and established or required to be maintained pursuant to Section 502.

“Gross Revenues” shall mean all revenues derived by the Authority from the imposition of fees, user fees, rates and charges for or related to the sale of water from the System (including standby fees, capacity charges and transportation fees and other fees, user fees, rates and charges for the use, services or availability of the System); fees, user fees, rates and charges imposed for the use, services or benefits derived from the Groundwater Reduction Plan or other groundwater withdrawal conservation efforts (including those imposed for the pumpage of water from water wells and those imposed for regulatory purposes); fees, user fees, or charges for the importation of water into the Authority’s boundaries; interest earned on amounts credited to any Pledged Funds and any other receipts from time to time designated as Gross Revenues by the Authority. The Authority has provided in a supplemental indenture that Gross Revenues shall also mean any payments received from the North Fort Bend Water Authority under Section 10.01 of the Joint Facilities Agreement. Gross Revenues shall not include any fees, user fees, rates, charges or receipts of revenues for Authority property outside the System or for fees or charges which by law may not be applied for the purposes to which Pledged Revenues are dedicated hereunder. Nor shall Gross Revenues include credits (including reimbursement credits) issued heretofore or hereafter by the Authority pursuant to State law (including Section 4.04 of the Act) or pursuant to contracts or policies of the Authority.

“Groundwater Reduction Plan” shall mean the groundwater reduction plan adopted by the Authority at its May 14, 2003, meeting, and any amendments or supplements thereto, which plan may be modified from time to time by the Authority in its sole discretion. Unless designated by the Authority in a Supplemental Indenture, the Groundwater Reduction Plan shall not include wells or groundwater withdrawals in Fort Bend County, Texas, or any groundwater reduction services and benefits provided by the Authority to the owners or operators of such wells or to the beneficiaries of such groundwater withdrawals. The Authority has designated via Supplemental Indenture “wells and groundwater withdrawals in Fort Bend County, Texas and groundwater reduction services and benefits provided by the Authority to the owners or operators of such wells or to the beneficiaries of such groundwater withdrawals” as part of the Groundwater Reduction Plan.

“Hedge Agreement” shall mean any agreement between the Authority and a qualifying financial institution (as described in the following sentence) for the purpose of providing an interest rate swap, cap, collar, floor, forward or other hedging mechanism, arrangement or security, however denominated, expressly identified pursuant to its terms as being entered into in connection with and in order to hedge interest rate fluctuations on any portion of any Bonds or Notes. A Hedge Agreement may only be entered into with a financial institution which has long term credit ratings in one of the two highest generic rating categories by at least two nationally recognized rating services.

“Joint Facilities Agreement” shall mean the Joint Facilities Agreement for Segments 0 & 1A, Bellaire Pump Station, and Second Source Waterline/Pump Stations between the Authority and North Fort Bend Water Authority dated July 1, 2011, as amended, including without limitation the First Amendment to Joint Facilities Agreement for Segments 0 & 1A, Bellaire Pump Station and Second Source Waterline/Pump Stations, dated March 1, 2012.

“Improvement Fund” shall mean the Improvement Fund established pursuant to Section 502.

“Indenture” shall mean this Indenture, as the same may be amended or supplemented from time to time by Supplemental Indentures in accordance with the terms hereof.

“Interest Payment Date” shall mean the date on which interest on the Bonds or any Notes is due and payable.

\* \* \*

“Investment Security” or “Investment Securities” shall mean and include any securities authorized for investment of Authority funds by the laws of the State of Texas, as the same may be amended from time to time.

“Junior Lien Bonds” means the Authority’s bonds issued in one or more Series as Junior Lien Bonds pursuant to this Indenture.

“Junior Lien Obligation” means an Obligation, the Authority’s Obligation on which is secured on a parity with Junior Lien Bonds, Junior Lien Notes and other Junior Lien Obligations.

“Junior Lien Credit Agreement” means a Credit Agreement, the Authority’s Obligation on which is secured on a parity with Junior Lien Bonds, Junior Lien Notes and other Junior Lien Obligations.

“Junior Lien Debt Service Fund” means the Junior Lien Debt Service Fund established pursuant to Section 502.

“Junior Lien Debt Service Reserve Fund” means the Junior Lien Debt Service Fund established pursuant to Section 502.

“Junior Lien Debt Service Reserve Fund Surety Policy” means a Debt Service Reserve Fund Surety Policy for the benefit of the Junior Lien Debt Service Reserve Fund.

“Junior Lien Hedge Agreement” means a Hedge Agreement, the Authority’s Obligation on which is secured on a parity with Junior Lien Bonds, Junior Lien Notes and other Junior Lien Obligations.

“Junior Lien Notes” means the Authority’s notes issued in one or more Series as Junior Lien Notes pursuant to this Indenture.

\* \* \*

“Maximum Annual Debt Service Requirements” for any class or classes of Bonds, Notes and Obligations shall mean the maximum Aggregate Debt Service scheduled to occur in respect of such Bonds, Notes, and Obligations in the current or any future Fiscal Year.

“Monthly O&M Transfer Amounts” shall mean the amounts certified in writing to the Trustee by an Authorized Officer of the Authority as being for each calendar month the designated portion of the amount budgeted by the Authority for Operating and Maintenance Expenses in such Fiscal Year. The Monthly O&M Transfer Amounts may vary by month to reflect varying seasonal expenses. The Authority may amend its budget at any time at its discretion.

“Net Revenues” shall mean Gross Revenues less Operating and Maintenance Expenses.

“Notes” shall mean any note or notes, as the case may be, issued in one or more Series pursuant to a commercial paper program or other borrowing program and authenticated and delivered under and pursuant to this Indenture, and secured by this Indenture. Notes may be issued as Parity Notes or Junior Lien Notes.

“O&M Fund” means the O&M Fund established pursuant to Section 502.

“O&M Reserve Account” shall mean the O&M Reserve Account established pursuant to Section 502.

“Obligations” shall mean any of the following obligations of the Authority issued or incurred pursuant to this Indenture:

- (a) Any and all repayment, reimbursement or other obligations arising pursuant to any Credit Agreement;
- (b) Any and all payment obligations arising pursuant to any Hedge Agreements net of amounts, if any, due the Authority pursuant to such Hedge Agreements; and
- (c) Any and all payment obligations arising pursuant to any Contract Obligations.

Obligations may be incurred as Parity Obligations or Junior Lien Obligations or, if arising in connection with Reserve Fund Surety Policies or Investment Liquidity Facilities for the benefit of the Debt Service Reserve Fund or the Junior Lien Debt Service Reserve Fund, shall be payable solely from the Debt Service Reserve Fund or the Junior Lien Debt Service Reserve Fund and the Pledged Revenues required to be deposited therein.

\* \* \*

“Operating and Maintenance Expenses” shall mean all current expenses of operating and maintaining the System and administering the Groundwater Reduction Plan, including water purchase expenses, water treatment expenses, water transmission and distribution expenses together with the salaries, labor, materials and administrative expenses that are allocable to the System or the Groundwater Reduction Plan, but shall expressly exclude depreciation, capital costs of the System and major repair and replacement costs.

\* \* \*

“Parity Bonds” means the Authority’s revenue bonds issued in one or more Series as Parity Bonds pursuant to this Indenture.

“Parity Credit Agreement” means a Credit Agreement, the Authority’s Obligation on which is secured on a parity with Parity Bonds, Parity Notes and other Parity Obligations.

“Parity Debt Service Reserve Fund Surety Policy” means a Debt Service Reserve Surety Policy for the benefit of the Debt Service Reserve Fund.

“Parity Hedge Agreement” means a Hedge Agreement, the Authority’s Obligation on which is secured on a parity with Parity Bonds, Parity Notes, and other Parity Obligations.

“Parity Notes” means the Authority’s notes issued in one or more Series as Parity Notes pursuant to this Indenture.

“Parity Obligation” means an Obligation, the Authority’s obligation on which is secured on a parity with Parity Bonds, Parity Notes and other Parity Obligations.

“Paying Agent” shall mean the Trustee or any bank or trust company or national or state banking association designated by the Authority to make payment of interest and principal of the Bonds or Notes of any Series, and its successor or successors, meeting the requirements of this Indenture. Different Series of Bonds and Notes may have different Paying Agents.

“Pledged Funds” shall mean the following:

- (a) for Parity Bonds, Parity Notes and Parity Obligations, the Revenue Fund, the Debt Service Fund, the Debt Service Reserve Fund and the Coverage Fund; and



(b) for Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations, the Revenue Fund, Junior Lien Debt Service Fund, the Junior Lien Debt Service Reserve Fund and the Coverage Fund; and

(c) for any Series of Bonds or Notes or any Obligation, such additional Funds or Accounts as shall be pledged by Supplemental Indenture.

“Pledged Revenues” shall mean:

- (a) Net Revenues; plus
- (b) amounts transferred to the Revenue Fund from the Coverage Fund; plus
- (c) any additional revenues hereafter designated as Pledged Revenues.

\* \* \*

“Record Date” as used with respect to any Interest Payment Date shall mean the date designated in any Supplemental Indenture with respect to any Series of Bonds or Notes as the record date for the payment of interest on such Series.

“Refunding Bonds” or “Refunding Notes” shall mean all Bonds or Notes, whether issued in one or more Series, issued for the purpose of refunding a like or different principal amount of Bonds or Notes, and any accrued interest thereon, and thereafter authenticated and delivered pursuant to this Indenture or any Supplemental Indenture.

\* \* \*

“Reserve Fund Requirement” shall mean for Parity Bonds and Notes the lesser of (i) Maximum Annual Debt Service Requirements or (ii) 125% of average annual Aggregate Debt Service on the Parity Bonds and Parity Notes (the “Parity Reserve Fund Requirement”), calculated as of the date of issuance of each Series, which calculations shall take into account the issuance of the Series of Bonds, Notes or Obligations being issued or incurred as of the date of calculation. The Reserve Fund Requirement for Junior Lien Bonds and Junior Lien Notes (the “Junior Lien Reserve Fund Requirement”), shall have such meaning as shall be provided by Supplemental Indenture.

\* \* \*

“Special Facilities” shall mean any water facilities, properties or assets, the cost of acquisition and operation of which is financed and supported solely with contractual payments or undertakings by third parties that do not constitute Pledged Revenues or Pledged Funds.

\* \* \*

“Subsidence District” shall mean the Harris-Galveston Coastal Subsidence District. Unless so provided by the Authority in a Supplemental Indenture, the term Subsidence District shall not include the Fort Bend Subsidence District. The Authority has provided via supplemental indenture that the term “Subsidence District” includes the Fort Bend Subsidence District.

“Supplemental Indenture” shall mean any Indenture supplemental to or amendatory of this Indenture, adopted by the Authority in accordance with Article X.

“System” shall mean the Authority’s water system as acquired and constructed from time to time, together with all Authority rights, facilities, and properties related thereto, including those of transmission, conveyance, distribution, collection, storage, impoundment, pressurization, and treatment. The System shall not include Special Facilities. Unless expressly provided by Supplemental Indenture, the System shall not include any rights, facilities, or property that serves territory in Fort Bend County, Texas. The Authority has provided via supplemental indenture that the “System” includes any rights, facilities or property that serves territory in Fort Bend County, Texas.

“Trust Estate” shall have the meaning assigned in Section 201.

\* \* \*

Section 201. Granting Clauses. To secure the payment of the principal of, redemption premium, if any, and interest on all Bonds and Notes whether at maturity or by prior redemption, and the payment of all Obligations and Debt Service

Expenses, and the performance and observance of all of the covenants and conditions herein and therein contained, and in consideration of the premises, the acceptance by the Trustee of the trusts hereby created, the purchase and acceptance of the Bonds and Notes and by the Owners thereof, the execution and delivery of the Obligations by the other parties thereto, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Authority does hereby GRANT, BARGAIN, CONVEY, ASSIGN, and PLEDGE to the Trustee and its successors in trust hereunder, subject to the provisions of this Indenture, all of the Authority's right, title and interest in and to the following described properties and interests, direct or indirect, whether now owned or hereafter acquired (collectively, the "Trust Estate"):

- (a) The Pledged Revenues and all rights to receive Pledged Revenues;
- (b) The Pledged Funds and all moneys deposited or required to be deposited therein;
- (c) Any investment income and proceeds derived from the Pledged Funds; and
- (d) Any and all property of every kind and nature (including without limitation, cash, obligations or securities) which may from time to time hereafter be conveyed, assigned, hypothecated, endorsed, pledged, mortgaged, granted, or delivered to or deposited with, the Trustee as additional security hereunder by the Authority, or which pursuant to any of the provisions hereof may come into the possession or control of the Trustee as security hereunder, or of a receiver lawfully appointed hereunder, all of which property the Trustee is authorized to receive, hold and apply according to the terms hereof;

PROVIDED, HOWEVER, that the Parity Bonds, Parity Notes and Parity Obligations shall be secured by a lien on Pledged Revenues that is senior and superior to the lien on Pledged Revenues securing the Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations; and Pledged Revenues shall first be applied to make all required deposits in and transfers to the Debt Service Fund and Debt Service Reserve Fund before making required deposits in and transfers to the Junior Lien Debt Service Fund and Junior Lien Debt Service Reserve Fund;

PROVIDED FURTHER, that the Pledged Funds securing the Parity Bonds, Parity Notes and Parity Obligations shall be the Revenue Fund (subject to the senior claim of Monthly O&M Transfer Amounts), the Debt Service Fund, the Debt Service Reserve Fund and the Coverage Fund; the Pledged Funds securing the Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations shall be the Revenue Fund (subject to the senior claim of Monthly O&M Transfer Amounts and the prior liens granted herein to secure Parity Bonds, Parity Notes and Parity Obligations), the Junior Lien Debt Service Fund, the Junior Lien Debt Service Reserve Fund and (subject to the prior liens granted herein to secure Parity Bonds, Parity Notes and Parity Obligations) the Coverage Fund; and

PROVIDED FURTHER, that Obligations arising in connection with Reserve Fund Surety Policies or Investment Liquidity Facilities for the benefit of the Debt Service Reserve Fund or the Junior Lien Debt Service Reserve Fund shall be secured solely by a lien on the Debt Service Reserve Fund or Junior Lien Debt Service Reserve Fund, as the case may be, and a lien on the Pledged Revenues required to be deposited therein subject to all prior liens on and applications of such Pledged Revenues.

TO HAVE AND TO HOLD all of the same, with all rights and privileges appurtenant thereto, unto the Trustee and its successors in trust forever;

\* \* \*

Section 501. The Pledge Effected by this Indenture. The Bonds, Notes and Obligations are payable from and secured by the Pledged Revenues, Pledged Funds and other properties and interests constituting the Trust Estate. The lien on and pledge of the Pledged Revenues, Pledged Funds and other properties and interests constituting the Trust Estate shall be effective as of the date of payment and delivery of the first series of Bonds.

Section 502. Establishment of Funds. The following Funds shall be authorized to be established and maintained:

- (1) Revenue Fund;
- (2) O&M Fund, including the O&M Reserve Account;
- (3) Debt Service Fund;
- (4) Debt Service Reserve Fund;
- (5) Junior Lien Debt Service Fund;

- (6) Junior Lien Debt Service Reserve Fund;
- (7) Coverage Fund;
- (8) Improvement Fund; and
- (9) Construction Fund.

The Revenue Fund, the Debt Service Fund, the Debt Service Reserve Fund, the Junior Lien Debt Service Fund, the Junior Lien Debt Service Reserve Fund and the Coverage Fund, and all Accounts within them, shall be established, held and maintained by the Trustee. The O&M Fund, including the O&M Reserve Account, the Improvement Fund and the Construction Fund, and all Accounts within them, shall be established, held and maintained by the Authority. The Authority reserves the right to establish additional funds and accounts not held by the Trustee to the extent not inconsistent with this Indenture. The Authority may from time to time request the Trustee to establish accounts and subaccounts within each Fund held by the Trustee for such purposes as may be provided herein or in any Supplemental Indenture.

Section 503. Revenue Fund. All Gross Revenues shall be promptly delivered to the Trustee for deposit to the credit of the Revenue Fund. In addition, there shall be deposited to the credit of the Revenue Fund all amounts transferred from the Coverage Fund pursuant to Section 510(1).

Section 504. Flow of Funds. Amounts on deposit in the Revenue Fund shall be used to make or provide for all payments, deposits, and transfers required by this Indenture by transfer to the following Funds and Accounts at the following times and in the following order of priority:

First, on or before the last business day of each month, the Trustee shall transfer to the Authority for credit to the O&M Fund the Monthly O&M Transfer Amount for the following month to be applied by the Authority for Operation and Maintenance Expenses.

Second, on or before the last business day of each month, and at such other times as shall be set forth in any Supplemental Indenture (but only after making the transfer required above), the Trustee shall transfer to the Debt Service Fund, amounts which, when added to other amounts in the Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Debt Service on all Parity Bonds, Parity Notes and Parity Obligations including the following:

- (a) any interest to become due and payable on each Series of Outstanding Parity Bonds and Parity Notes on the next Interest Payment Date for such Series; and
- (b) any principal scheduled to become due and payable on any Series of Parity Bonds within the following twelve months;
- (c) if provided in any Supplemental Indenture, any provision for the payment of principal on any Parity Notes;
- (d) unless otherwise provided in any Supplemental Indenture, any amounts due on Parity Obligations;
- (e) unless otherwise provided in any Supplemental Indenture, any amounts required to pay all related Debt Service Expenses.

Third, if the Debt Service Reserve Fund contains less than the Reserve Fund Requirement, on or before the last business day of each month (but only after making all transfers required above) the Trustee shall transfer to the Debt Service Reserve Fund the amount required by a Supplemental Indenture to attain or re-establish the Reserve Fund Requirement, which transfers shall continue until the Debt Service Reserve Fund contains the Reserve Fund Requirement; provided, however, that by Supplemental Indenture, the Authority may provide for other or greater transfers in connection with the purchase or acquisition of any Parity Debt Service Reserve Fund Surety Policy.

Fourth, when and if Junior Lien Bonds, Junior Lien Notes or Junior Lien Obligations have been issued and are Outstanding, on or before the last business day of each month, and at such other times as shall be set forth in any Supplemental Indenture (but only after making all transfers required above), the Trustee shall transfer to the Junior Lien Debt Service Fund, amounts which, when added to other amounts in the Junior Lien Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Junior Lien Debt Service on all Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations including the following:

(a) any interest to become due and payable on each Series of Outstanding Junior Lien Bonds and Junior Lien Notes on the next Interest Payment Date for such Series; and

(b) any principal scheduled to become due and payable on any Series of Junior Lien Bonds within the following twelve months;

(c) if provided in any Supplemental Indenture, any provision for the payment of principal on any Junior Lien Notes;

(d) unless otherwise provided in any Supplemental Indenture, any amounts due on Junior Lien Obligations;

(e) unless otherwise provided in any Supplemental Indenture, any amounts required to pay all related Debt Service Expenses.

Fifth, when and if Junior Lien Bonds, Junior Lien Notes or Junior Lien Obligations have been issued and are Outstanding, if the Junior Lien Debt Service Reserve Fund contains less than the Reserve Fund Requirement, on or before the last business day of each month, (but only after making all transfers required above) the Trustee shall transfer to the Junior Lien Debt Service Reserve Fund the amount required by a Supplemental Indenture to attain or re-establish the Reserve Fund Requirement, which transfers shall continue until the Junior Lien Debt Service Reserve Fund contains the Reserve Fund Requirement; provided, however, that by Supplemental Indenture, the Authority may provide for other or greater transfers in connection with the purchase or acquisition of any Junior Lien Debt Service Reserve Fund Surety Policy.

Sixth, whenever the Coverage Fund contains less than the Coverage Fund Requirement, on or before the last business day of each month (but only after making all transfers required above) the Trustee shall transfer to the Coverage Fund to the extent funds are available in the Revenue Fund (i) in the first month of such Fiscal Year, an amount sufficient to produce a balance in the Coverage Fund equal to the Coverage Fund Requirement, and (ii) in each succeeding month, one-twelfth of the Coverage Fund Requirement until the Coverage Fund Requirement has been re-established.

Seventh, whenever the balance in the O&M Reserve Account contains less than two months (or any greater period designated by the Authority) of Operation and Maintenance Expenses according to the Authority's then current budget, on or before the last business day of each month (but only after making all transfers required above) the Trustee shall transfer to the Authority for credit to the O&M Reserve Account the amount necessary to re-establish such balance.

Eighth, on or before the last business day of each month (but only after making all transfers required above) all remaining amounts shall be transferred to the Improvement Fund.

Section 505. Other Transfers. Notwithstanding anything in this Article to the contrary, if on any Interest Payment Date, or on any principal payment date, or on any other date there are not sufficient Pledged Revenues to make the transfers to the Debt Service Fund, the Debt Service Reserve Fund, the Junior Lien Debt Service Fund or the Junior Lien Debt Service Reserve Fund to pay when due interest or principal of or any other payments on any Bonds, Notes or Obligations, there may be transferred at the Authority's discretion, from any lawfully available source, the amount which will result in the appropriate Fund having the balances required to be on deposit therein; provided that no transfer will be made from proceeds of one issue of Bonds or Notes to pay debt service on another issue of Bonds or Notes unless authorized by Supplemental Indenture. The Authority shall be permitted to reimburse itself for any such transfers from the Improvement Fund.

Section 506. Debt Service Fund.

(1) Unless provision for payment has been made with the Paying Agent, there shall be paid out of the Debt Service Fund on or before each Interest Payment Date for any of the Parity Bonds and Parity Notes, the amount required for the interest payment on such date. There shall be paid out of the Debt Service Fund on or before each principal payment date, the amount required for the principal payable on such due date on Parity Bonds and, to the extent required by Supplemental Indenture, on Parity Notes. On or before any redemption date for Parity Bonds or Parity Notes to be redeemed, there shall also be paid out of the Debt Service Fund the amount required for the payment of the redemption price of and interest on the Parity Bonds or Parity Notes then to be redeemed. On or before any other payment date set forth in any Supplemental Indenture, there shall also be paid out of the Debt Service Fund the amounts required to be paid on any Parity Obligations on such payment date.

(2) The Trustee shall, at any time at the direction of the Authority, apply amounts available in the Debt Service Fund, or from other Pledged Revenues, for the payment of any scheduled mandatory or sinking fund redemptions on Parity Bonds issued as "term bonds" to pay the purchase price (including any brokerage and other charges) for any Bond subject to such mandatory or sinking fund redemption provided that such purchase price shall not exceed the applicable

mandatory redemption price of such Parity Bond. Upon any such purchase, the purchased Parity Bonds shall be delivered to the Trustee or Registrar for cancellation and the principal amount of such Parity Bonds purchased shall be credited toward the next mandatory redemption or sinking fund installment.

(3) There shall also be paid out of the Debt Service Fund at the written direction of the Authority any amounts required to pay Debt Service Expenses related to Parity Bonds, Parity Notes and Parity Obligations.

Section 507. Debt Service Reserve Fund.

(1) If on any Interest Payment Date, principal payment date, or any other date, after giving effect to all transfers to the Debt Service Fund pursuant to Sections 504 and 505, the amount in the Debt Service Fund shall be less than the amount required to make all payments of interest, principal, and any redemption price, of the Parity Bonds and Parity Notes then due and payable or to make any other then required payments on Parity Obligations, the Trustee shall apply amounts from the Debt Service Reserve Fund to the extent necessary to make such payments.

(2) When the amount in the Debt Service Reserve Fund, together with the amounts in the Debt Service Fund, is sufficient to fully pay all Outstanding Parity Bonds, Parity Notes and Parity Obligations in accordance with their terms (including principal or redemption price and interest thereon), the funds on deposit in the Debt Service Reserve Fund at the direction of the Authority may be used to pay the principal and redemption price of and interest on all Outstanding Parity Bonds and Parity Notes and to pay all other Parity Obligations.

(3) In lieu of cash or Investment Securities, the Reserve Fund Requirement for the Debt Service Reserve Fund may be satisfied in whole or in part with one or more Debt Service Reserve Fund Surety Policies. Such Debt Service Reserve Fund Surety Policies may be drawn upon on a proportionate basis only after all other amounts in the Debt Service Reserve Fund have been used or applied. In the event the Debt Service Reserve Fund holds one or more Debt Service Reserve Fund Surety Policies, any Pledged Revenues required to be deposited into the Debt Service Reserve Fund shall first be used on a proportionate basis to reimburse and repay issuers of Debt Service Reserve Fund Surety Policies for amounts drawn thereon together with interest thereon and related costs, all as may be more fully provided by Supplemental Indenture.

(4) If the amount in the Debt Service Reserve Fund exceeds the Reserve Fund Requirement and all reimbursement and repayment obligations pursuant to any Debt Service Reserve Fund Surety Policy have been satisfied, the Authority may direct the Trustee to transfer such excess to the Debt Service Fund or to any other Fund or Account which shall reduce by such amount the amount otherwise required to be deposited therein. If any money is ever withdrawn from the Debt Service Reserve Fund or amounts are drawn under a Debt Service Reserve Fund Surety Policy for the purpose of paying the principal of or interest on the Parity Bonds and the Parity Notes, the Authority shall deposit into the Debt Service Reserve Fund the amounts necessary to restore the Debt Service Reserve Fund Requirement (which amounts may be deposited in equal monthly payments for a period not to exceed 12 months), or such larger balance as may be required by a Supplemental Indenture.

(5) The Authority may provide in the Supplemental Indenture that the Reserve Fund Requirement for the Debt Service Reserve Fund be funded (i) from the proceeds of Parity Bonds or Parity Notes, (ii) with a Debt Service Reserve Fund Surety Policy, (iii) from any other source or (iv) from any combination thereof.

Section 508. Junior Lien Debt Service Fund.

(1) Unless provision for payment has been made with the Paying Agent, there shall be paid out of the Junior Lien Debt Service Fund on or before each Interest Payment Date for any of the Junior Lien Bonds and Junior Lien Notes, the amount required for the interest payment on such date. There shall be paid out of the Junior Lien Debt Service Fund on or before each principal payment date, the amount required for the principal payable on such due date on Junior Lien Bonds and, to the extent required by Supplemental Indenture, on Junior Lien Notes. On or before any redemption date for Junior Lien Bonds or Junior Lien Notes to be redeemed, there shall also be paid out of the Junior Lien Debt Service Fund the amount required for the payment of the redemption price of and interest on the Junior Lien Bonds or Junior Lien Notes then to be redeemed. On or before any other payment date set forth in any Supplemental Indenture, there shall also be paid out of the Junior Lien Debt Service Fund the amounts required to be paid on any Junior Lien Obligations on such payment date.

(2) The Trustee shall, at any time at the direction of the Authority, apply amounts available in the Junior Lien Debt Service Fund, or from other Pledged Revenues, for the payment of any scheduled mandatory or sinking fund redemptions on Junior Lien Bonds issued as "term bonds" to pay the purchase price (including any brokerage and other charges) for any Junior Lien Bond subject to such mandatory or sinking fund redemption provided that such purchase price shall not exceed the applicable mandatory redemption price of such Junior Lien Bond. Upon any such purchase, the purchased Junior Lien Bonds shall be delivered to the Trustee or Registrar for cancellation and the principal amount of such Junior Lien Bonds purchased shall be credited toward the next mandatory redemption or sinking fund installment.

(3) There shall also be paid out of the Junior Lien Debt Service Fund at the written direction of the Authority any amounts required to pay Debt Service Expenses related to Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations.

Section 509. Junior Lien Debt Service Reserve Fund.

(1) If on any Interest Payment Date, principal payment date, or any other date, after giving effect to all transfers to the Junior Lien Debt Service Fund pursuant to Sections 504 and 505, the amount in the Junior Lien Debt Service Fund shall be less than the amount required to make all payments of interest, principal, and any redemption price, of the Junior Lien Bonds and Junior Lien Notes then due and payable or to make any other then required payments on Junior Lien Obligations, the Trustee shall apply amounts from the Junior Lien Debt Service Reserve Fund to the extent necessary to make such payments.

(2) When the amount in the Junior Lien Debt Service Reserve Fund, together with the amounts in the Junior Lien Debt Service Fund, is sufficient to fully pay all Outstanding Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations in accordance with their terms (including principal or redemption price and interest thereon), the funds on deposit in the Junior Lien Debt Service Reserve Fund at the direction of the Authority may be used to pay the principal and redemption price of and interest on all Outstanding Junior Lien Bonds and Junior Lien Notes and to pay all other Junior Lien Obligations.

(3) In lieu of cash or Investment Securities, the Reserve Fund Requirement for the Junior Lien Debt Service Reserve Fund may be satisfied in whole or in part with one or more Debt Service Reserve Fund Surety Policies. Such Debt Service Reserve Fund Surety Policies may be drawn upon on a proportionate basis only after all other amounts in the Junior Lien Debt Service Reserve Fund have been used or applied. In the event the Junior Lien Debt Service Reserve Fund holds one or more Debt Service Reserve Fund Surety Policies, any Pledged Revenues required to be deposited into the Junior Lien Debt Service Reserve Fund shall first be used on a proportionate basis to reimburse and repay issuers of Debt Service Reserve Fund Surety Policies for amounts drawn thereon together with interest thereon and related costs, all as may be more fully provided by Supplemental Indenture.

(4) If the amount in the Debt Service Reserve Fund exceeds the Reserve Fund Requirement and all reimbursement and repayment obligations pursuant to any Debt Service Reserve Fund Surety Policy have been satisfied, the Authority may direct the Trustee to transfer such excess to the Junior Lien Debt Service Fund or to any other Fund or Account which shall reduce by such amount the amount otherwise required to be deposited therein. If any money is ever withdrawn from the Junior Lien Debt Service Reserve Fund or amounts are drawn under a Debt Service Reserve Fund Surety Policy for the purpose of paying the principal of or interest on the Junior Lien Bonds and the Junior Lien Notes, the Authority shall deposit into the Junior Lien Debt Service Reserve Fund the amounts necessary to restore Junior Lien Debt Service Reserve Fund Requirement (which amounts may be deposited in equal monthly payments for a period not to exceed 12 months), or such larger balance as may be required by a Supplemental Indenture.

(5) The Authority may provide in the Supplemental Indenture that the Reserve Fund Requirement for the Junior Lien Debt Service Reserve Fund be funded (i) from the proceeds of Junior Lien Bonds or Junior Lien Notes, (ii) with a Debt Service Reserve Fund Surety Policy, (iii) from any other source, or (iv) from any combination thereof.

Section 510. Coverage Fund. Following the establishment of a Coverage Fund Requirement and resulting funding of the Coverage Fund:

(1) On the first Business Day of each succeeding calendar year, there shall be transferred to the Revenue Fund from the Coverage Fund an amount equal the Coverage Fund Requirement (or so much thereof as shall be on deposit in the Coverage Fund).

(2) Amounts in the Coverage Fund also shall be transferred to the Debt Service Fund and Junior Lien Debt Service Fund to the extent required to pay principal and/or interest on any Bonds, Notes or Obligations as they become due and payable or to allow monthly transfers to such Funds to be made if no other amounts are available.

Section 511. O&M Reserve Account. The O&M Reserve Account shall be held by the Authority as an Account within the O&M Fund. Amounts in the O&M Reserve Account may be used by the Authority to pay Operation and Maintenance Expenses and costs of repairs and replacements to the System (whether major or minor).

Section 512. Improvement Fund. Amounts in the Improvement Fund may be used by the Authority for any lawful purposes. To the extent available, amounts in the Improvement Fund shall be transferred to the Debt Service Fund and Junior Debt Service Fund to the extent required to pay principal and/or interest on any Bonds, Notes or Obligations as they become due and payable. In addition, in the event the Coverage Fund Requirement is not established in the Coverage Fund on

the last Business Day of the penultimate month of each Fiscal Year, after all transfers required by Section 504 have been made, the Trustee shall send the Authority an invoice by the first Business Day of the last month of such Fiscal Year for the additional amount needed to re-establish the Coverage Fund Requirement by the end of such Fiscal Year. The Authority shall pay to the Trustee from the Improvement Fund for credit to the Coverage Fund the amount of such invoice within 30 days of the date of the invoice.

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Section 601. General. All moneys held by the Trustee under the provisions of this Indenture shall be deposited with the Trustee and applied as herein provided for the benefit of the Owners of the Bonds. All moneys held by the Authority under this Indenture shall be deposited with one or more Depositories in the name of the Authority and applied only in accordance with the provisions of this Indenture.

Section 602. Deposits and Transfers.

(1) All moneys deposited with the Trustee shall be credited to the particular Fund or Account to which such moneys belong.

(2) Any transfer required to be made from one Fund or Account to another Fund or Account may be made by a book entry transfer of any moneys or investments or portions of investments without liquidating any investments in order to make such transfer unless the funds required to be transferred are needed to make payments out of the Fund or Account to which such funds were transferred at the time of transfer. All transfers shall be made at their Fair Market Value.

Section 603. Investment of Certain Funds.

(1) Moneys in the Funds and Accounts held by the Trustee shall be invested and reinvested by the Trustee as promptly as practicable, in accordance with written instructions from the Authority, and moneys in all other Funds and Accounts shall be invested and reinvested by the Authority, in each case to the fullest extent practicable and if permitted by law, in Investment Securities the proceeds of which the Authority estimates will be received not later than such times as shall be necessary to provide moneys when needed for payments to be made from each such Fund or Account. Each instruction regarding the investment of the Funds shall constitute a representation by the Authority that the securities into which such investment is directed are Investment Securities. Notwithstanding anything herein to the contrary, Investment Securities in all Funds and Accounts shall mature not later than such times as shall be necessary to provide moneys when needed for payments to be made from such Funds and Accounts; provided, however, that any Investment Securities for which the Authority or Trustee shall hold an Investment Liquidity Facility shall be deemed to have a maturity equal to the period of notice of purchase to the issuer of the Investment Liquidity Facility.

(2) Interest earned or profits realized from investing any moneys in any Fund or Account shall remain in such Fund or Account except as follows: (i) so long as the Debt Service Reserve Fund contains the Reserve Fund Requirement, all such interest and profits shall be transferred to the Debt Service Fund; (ii) so long as the Junior Lien Debt Service Fund contains the Reserve Fund Requirement, all such interest and profits shall be transferred to the Junior Lien Debt Service Fund; and (iii) all moneys representing capitalized interest for Bonds or Notes deposited in the Debt Service Fund, the Junior Lien Debt Service Fund or the Construction Fund may be retained in such Funds. Interest earned from the investment of any moneys in any other Fund or Account may be transferred by the Authority or at the direction of the Authority into the Debt Service Fund, the Junior Lien Debt Service Fund or the Rebate Fund.

Section 604. Valuation and Sale of Investments.

(1) Investment Securities acquired as an investment of moneys in any Fund or Account created under the provisions of this Indenture shall be at all times a part of such Fund or Account and any profit or loss realized from the liquidation of such investment shall be applied to such Fund or Account.

(2) In computing the amount in the Debt Service Reserve Fund and Junior Lien Debt Service Reserve Fund, obligations purchased as an investment of moneys therein shall be valued not less frequently than annually at their Fair Market Value plus accrued interest except that time deposits shall be valued at cost plus accrued interest; provided however that (i) Investment Securities subject to an Investment Liquidity Facility shall never be valued at less than the amount for which they are subject to being purchased pursuant to such Investment Liquidity Facility and (ii) any U.S. Treasury Obligations – State and Local Series, shall be continuously matured at their par value.

(3) Except as otherwise provided in this Indenture, the Trustee shall sell at the market value at time of the sale or present for redemption, any Investment Security so purchased as an investment whenever it shall be

requested in writing by an Authorized Officer of the Authority to do so. The Trustee shall not be liable or responsible for making any such investment in the manner provided in this Article or for any loss resulting from any such investment.

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The Authority represents, covenants and agrees with the Owners of all Bonds, Notes and other Obligations as follows:

Section 701. Design, Construction, Maintenance and Operation of System.

(a) To the extent under the Authority's control, the Authority shall cause the System to be designed, developed and constructed in accordance with applicable law and sound engineering standards; the Authority will cause it to be maintained in good condition and working order in accordance with law; and the Authority will cause it to be operated in an efficient and economical manner in accordance with law.

(b) The Authority shall insure the portion of the System that is downstream of the various point(s) of delivery of water from the entity(ies) providing water to the Authority with insurers of good standing against risks, accidents and casualties to the extent customarily insured against by political subdivisions of the State of Texas and to the extent such insurance is reasonably available. All net proceeds of such insurance (except business interruption insurance, if any) shall be applied to repair or replace the insured property that is damaged or destroyed or used to redeem Bonds, Notes or Obligations. The Authority shall not be required to insure any portion of the System that is not owned, controlled and operated by the Authority.

(c) The Authority shall cause the portion of the System that is downstream of the various point(s) of delivery of water from the entity(ies) providing water to the Authority to be inspected by an independent firm of engineers experienced in conducting inspections of such properties and facilities no less frequently than every five years beginning on the fifth year following the year the first portions of the System are placed in service. A report and recommendations shall be prepared by the firm conducting such inspection, a copy of which shall be filed with the Trustee.

Section 702. Sale or Encumbrance. The Authority will not sell, dispose of or encumber the System as a whole or any substantial portion thereof; provided, however, the Authority shall have the authority to sell or dispose of any obsolete, worn out or surplus property, equipment and facilities that are no longer needed for efficient operation of the System, are obsolete or are to be replaced. Net proceeds from any such sale or disposition shall be deposited to the credit of the Improvement Fund and applied for replacements, betterments, additions or expansions to the System or for other lawful purposes of the Authority.

Section 703. Rates and Charges. The Authority shall fix, charge and collect fees, user fees, rates and charges which, in the aggregate, are calculated to be fully sufficient to generate Gross Revenues adequate to produce either:

(i) Pledged Revenues in each Fiscal Year which, together with balances in the O&M Reserve Account and the Improvement Fund at the end of such Fiscal Year, are at least equal to 120% of the principal and interest and other payment requirements scheduled to occur in such Fiscal Year on all Parity Bonds, Parity Notes and Parity Obligations then Outstanding; or

(ii) Net Revenues in each Fiscal Year which are at least equal to 110% of the principal and interest and other payment requirements scheduled to occur in such Fiscal Year on all Parity Bonds, Parity Notes and Parity Obligations then Outstanding.

In fixing, charging and collecting fees, user fees, rates and charges, the Authority shall take into account all credits (including reimbursement credits) issued heretofore or hereafter by the Authority pursuant to State law (including Section 4.04 of the Act) or pursuant to contracts or policies of the Authority.

The Authority agrees to exercise its power to impose and collect fees, user fees, or charges for the importation of water into the Authority's boundaries, if determined necessary by the Authority and as allowed by the Act, in order to satisfy the Authority's obligations under this Indenture.

The Authority will not grant or permit any free service from or use of the Groundwater Reduction Plan or System, except to the Authority or as may be authorized by law.

If the Pledged Revenues in any Fiscal Year are less than the amount specified above, the Authority, promptly upon receipt of the annual audit for such Fiscal Year, must request an independent nationally recognized rate consultant to make its recommendations, if any, as to a revision of the Authority's rates, fees and charges, its budgeted Operation and Maintenance Expenses or its method of operation of the System in order to satisfy as quickly as practicable the foregoing requirements. A copy of such request and recommendations of such consultant shall be filed with the Trustee. So long as the Authority substantially complies in a timely fashion with the recommendation contained in such report, the Authority will not be deemed to



have defaulted in a performance of its duties under this Section even if the resulting Pledged Revenues are not sufficient to be in compliance with the covenant set forth above, so long as there is no other default hereunder and the Debt Service Reserve Fund is fully funded.

Section 704. Compliance with Groundwater Reduction Requirements. The Authority shall comply with the rules and regulations of the Subsidence District, as amended, and it shall comply with the terms and provisions of its Groundwater Reduction Plan, as amended by the Authority, to the extent necessary to comply with the rules and regulations of the Subsidence District.

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Section 801. Events of Default. An Event of Default hereunder shall consist of any of the following acts or occurrences:

(1) failure to pay when due principal or interest on any Parity Bonds, Parity Notes or Parity Obligations; or

(2) the Authority shall default in the due and punctual performance of any other of the covenants, conditions and provisions herein and such default shall continue for 30 days (or such longer period as shall be reasonably required to remedy the same) after receipt of written notice from the Trustee specifying such default and requiring the same to be remedied; or

(3) The entry of a decree or order by a court having jurisdiction in the premises adjudging the Authority a bankrupt or insolvent, or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition of or in respect of the Authority under the Federal Bankruptcy Code or any other applicable federal or state law, or appointing a receiver, liquidator, assignee, or sequestrator (or other similar official) of the Authority or of any substantial part of its property, or ordering the winding up or liquidation of its affairs, and the continuance of any such decree or order unstayed and in effect for a period of 60 consecutive days; or

(4) The institution by the Authority of proceedings to be adjudicated a bankrupt or insolvent, or the consent by it to the institution of a bankruptcy or insolvency proceedings against it, or the filing by it of a petition or answer or consent seeking reorganization or relief under the Federal Bankruptcy Code or any other similar applicable federal or state law, or the consent by it to the filing of any such petition or to the appointment of a receiver, liquidator, assignee, trustee or sequestrator (or other similar official) of the Authority or of any substantial part of its property, or the making by it of an assignment for the benefit of creditors, or the admission by it in writing of its inability to pay its debts generally as they become due.

For purposes of determining whether an Event of Default has occurred under this Section 801(1), no effect shall be given to payments made under any bond insurance policy.

By Supplemental Indenture, additional events of default may be established for Junior Lien Bonds, Junior Lien Notes and Junior Lien Obligations; however, unless expressly provided to the contrary, none of them shall constitute an Event of Default for Parity Bonds, Notes or Obligations.

Section 802. Notices. In order to provide the Authority with information with respect to its obligations under this Indenture, the Trustee shall provide the Authority a notice if there are any draws upon the Debt Service Reserve Fund or Junior Lien Debt Service Reserve Fund which are required to be transferred to the Debt Service Fund or Junior Lien Debt Service Fund for the payment of principal or interest on any Bonds, Notes or Obligations, together with the description of the amount drawn.

Section 803. Notice of Default. The Trustee shall also be required to give prompt notice to the Authority of the occurrence of any Event of Default hereunder or of any event which, with the passage of time, could become an Event of Default.

Section 804. Remedies in General. If an Event of Default hereunder shall occur and be continuing, then, in addition to all of the other rights and remedies granted to the Trustee hereunder, the Trustee, subject to the provisions of this Indenture, may proceed to protect and enforce its rights and the rights of the Owners of Bonds, Notes or Obligations by suit, action or proceeding in equity or at law or otherwise, whether for the specific performance of any covenant or agreement contained in this Indenture or any Supplemental Indenture or in aid of the execution of any power granted in this Indenture or for the enforcement of any other legal, equitable or other remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce any of the rights of the Trustee or such Owners of Bonds, Notes or Obligations, including, without limitation, the right to seek a writ of mandamus issued by a court of competent jurisdiction compelling the members of the Board or other officers of the Authority to make payment of the Pledged Revenues (but only from and to the extent of the sources

provided in this Indenture or Supplemental Indenture), to apply the Pledged Funds as provided in this Indenture and any Supplemental Indenture or to observe and perform such covenant, obligations or conditions of this Indenture or any Supplemental Indenture, including without limitation the covenant with respect to rates and charges for the System.

Section 805. Appointment of Receivers. If an Event of Default hereunder shall occur and be continuing, and upon filing of a bill in equity or commencement of other judicial proceedings to enforce the rights of the Trustee and the Owners hereunder, the Trustee shall be entitled as a matter of right, and to the extent permitted by law, to the appointment of a receiver or receivers of the Pledged Revenues and the income, rents, profits and use thereof pending such proceedings, with such powers as the court making such appointment shall confer.

Section 806. Trustee May Act Without Possession of Bonds, Notes or Obligations. All rights of action under this Indenture or any Supplemental Indenture may be enforced by the Trustee without possession of any of the Bonds, Notes or Obligations or the production thereof on any trial or other proceedings relative thereto, and any such suit or proceedings instituted by the Trustee shall be brought in its name, as Trustee for the ratable benefit of the Owners of the Bonds, Notes or Obligations, subject to the provisions of this Indenture or any Supplemental Indenture.

Section 807. Trustee as Attorney in Fact. The Trustee is hereby appointed (and the Owners of the Bonds, Notes or Obligations, by taking and owning same from time to time, shall be deemed to have so appointed the Trustee) the true and lawful attorney in fact of the Owners to make or file, in the names of the Owners or in behalf of all Owners as a class, any proof of debt, amendment to proof of debt, petition or other document, and to do and perform any and all acts and things for and in the name of the Owners as a class as may be necessary or advisable, in the judgment of the Trustee, in order to have the claims of the Owners against the Authority approved in any equity receivership, insolvency, liquidation, bankruptcy, reorganization or other proceedings to which the Authority shall be a party and to receive payment of or on account of such claims. Any such receiver, assignee, liquidator or trustee is hereby authorized by each of the Owners to make such payments to the Trustee, and, in the event that the Trustee shall consent to the making of such payments directly to the Owners, to pay to the Trustee any amount due for compensation and expenses of the Trustee, including counsel fees, incurred up to the date of such distribution, and the Trustee shall have full power of substitution and delegation in respect of any such powers.

Section 808. Remedies Not Exclusive. No remedy herein conferred upon or reserved to the Trustee is intended to be exclusive of any other available remedy or remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given hereunder or under the Bonds, Notes or Obligations, or now or hereafter existing at law or in equity or by statute. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein, and every such right and power may be exercised from time to time and as often as may be deemed expedient.

Section 809. Limitation on Suits. All rights of action in respect of this Indenture shall be exercised only by the Trustee, and no Owner secured hereunder shall have any right to institute any suit, action or proceeding at law or in equity for the appointment of a receiver or for any other remedy hereunder or by reason hereof, unless and until the Trustee shall have received written request of the Owners of not less than twenty-five percent (25%) in aggregate principal amount of the Bonds, Notes or Obligations then Outstanding and shall have been furnished reasonable indemnity and shall have refused or neglected for thirty (30) days thereafter to institute such suit, action or proceedings. The making of such request and the furnishing of such indemnity shall in each and every case be conditions precedent to the execution and enforcement by any Owner of the powers and remedies given to the Trustee hereunder and to the institution and maintenance by any such Owner of any action or cause of action for the appointment of a receiver or for any other remedy hereunder, but the Trustee may, in its discretion, and when duly requested in writing by the Owners of not less than twenty-five percent (25%) in aggregate principal amount of the Bonds, Notes or Obligations then Outstanding and when furnished indemnity satisfactory to protect it against expenses, charges and liability shall, forthwith, take such appropriate action by judicial proceedings or otherwise in respect of any existing default on the part of the Authority as the Trustee may deem expedient in the interest of the Owners.

Nothing contained in this Article, however, shall affect or impair the right of any Owner, which shall be absolute and unconditional, to enforce the payment of the principal and interest on the Bonds, Notes or Obligations of such Owner, but only out of the moneys for such payment as herein provided, or the obligation of the Authority, which shall also be absolute and unconditional, to make payment of the principal and interest on the Bonds, Notes or Obligations issued hereunder, but only out of the funds provided herein for such payment, to the respective Owners thereof at the time and place stated in said Bonds, Notes or Obligations.

Section 810. Right of Owners of the Bonds, Notes or Obligations to Direct Proceedings. Notwithstanding any provision of this Indenture to the contrary, the Owners of more than fifty percent (50%) in aggregate principal amount of the Bonds, Notes or Obligations then Outstanding shall have the right, at any time, subject to the provisions of this Article VIII, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the time, method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of this Indenture or for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee or any other proceedings hereunder; provided, however, that such direction shall not be contrary to law or the provisions of this Indenture, and the Trustee shall have the right to

decline to follow any such direction if the Trustee in good faith shall determine that the proceeding so directed would involve it in personal liability or would be unjustly prejudicial to the Owners not consenting.

Section 811. Restoration of Rights and Remedies. If the Trustee or any Owner has instituted any proceeding to enforce any right or remedy under this Indenture and such proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or to such Owner, then and in every such case the Authority, the Trustee and the Owners shall, subject to any determination in such proceeding, be restored severally and respectively to their former positions hereunder, and thereafter all rights and remedies of the Trustee and the Owners shall continue as though no such proceeding had been instituted.

Section 812. Waiver of Stay or Extension Laws. To the extent that it may lawfully do so, the Authority covenants that it will not at any time insist upon, plead or in any manner whatsoever claim or take the benefit or advantage of any stay or extension law whenever or wherever enacted, which may affect the covenants or the performance of this Indenture. The Authority also covenants that it will not otherwise hinder, delay or impede the execution of any power herein granted to the Trustee.

Section 813. Delay or Omission Not Waiver. No delay or omission of the Trustee or of any Owner to exercise any right or remedy accruing upon any Event of Default hereunder shall impair any such right or remedy or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given by this Article or by law to the Trustee or to the Owners may be exercised from time to time, and as often as may be deemed expedient, by the Trustee or by the Owners, as the case may be.

Section 814. Special Provisions for Issuers of Credit Agreements. Any Supplemental Indenture may provide that the issuer of any Credit Agreement guaranteeing payment of the principal of and interest on any Bonds or Notes may exercise the rights of such Owners of the guaranteed Bonds or Notes with respect to the exercise of any rights granted to such Owners in this Article VIII or in Article IX.

\* \* \*

Section 906. Removal of Trustee. The Trustee may be removed with or without cause at any time by the Authority if no Event of Default has occurred and is continuing, or, if an Event of Default has occurred and is continuing, by the Owners of a majority in principal amount of the Bonds and Notes then Outstanding, by an instrument or concurrent instruments in writing signed and acknowledged by such Owners or by their attorneys in fact duly authorized and delivered to the Authority, provided that such removal shall not take effect until a successor is appointed and has accepted such appointment. Copies of each instrument providing for any such removal shall be delivered by the Authority to the Trustee and any successor thereof.

Section 907. Resignation of Trustee. The Trustee may at any time resign and be discharged from the trusts hereby created by giving written notice to the Authority and by providing written notice to the Owners of its intended resignation at least sixty (60) days in advance thereof. Such notice shall specify the date on which such resignation shall take effect and shall be sent by first class mail, postage prepaid to each registered Owner of Bonds and Notes. Resignation by the Trustee shall not take effect unless and until a successor to such Trustee shall have been appointed as hereinafter provided.

Section 908. Appointment of Successor Trustee. In case the Trustee hereunder shall resign, or shall be removed or dissolved, or shall be in the course of dissolution or liquidation, or shall otherwise become incapable of acting hereunder, or in case the Trustee shall be taken under control of any public officer or officers or a receiver appointed by a court, a successor may be appointed by the Owners of a majority in principal amount of the Bonds and Notes then Outstanding, by an instrument or concurrent instruments in writing, signed by such Owners or their duly authorized representatives and delivered to the Trustee, with notice thereof given to the Authority; provided, however, that in any of the events above mentioned, the Authority may nevertheless appoint a temporary Trustee to fill such vacancy until a successor shall be appointed by the Owners in the manner above provided, and any such temporary Trustee so appointed by the Authority shall immediately and without further act be automatically succeeded by the successor to the Trustee appointed by the Owners. The Authority shall provide written notice to the Owners of the appointment of any successor Trustee, whether temporary or permanent, in the manner provided in the preceding Section of this Indenture for providing notice of the resignation of the Trustee.

Any successor Trustee or temporary Trustee shall be a trust company or bank in good standing located in or incorporated under the laws of the State of Texas duly authorized to exercise trust powers and subject to examination by federal or State authority, having a reported capital and surplus of not less than \$100,000,000.

In the event that no appointment of a successor Trustee is made by the Owners or by the Authority pursuant to the foregoing provisions of this Section at the time a vacancy in the office of the Trustee shall have occurred, the Owner of any Bonds and Notes issued hereunder or the retiring Trustee may apply to any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice as it shall deem proper, if any, appoint a successor Trustee.

\* \* \*

Section 1001. Supplemental Indentures. For any one or more of the following purposes and at any time or from time to time, a Supplemental Indenture of the Authority may be adopted without the need for consent by the Owners, which Supplemental Indenture shall be fully effective in accordance with its terms:

(1) To authorize Bonds, Notes and other Obligations and, in connection therewith, to specify and determine the matters and things referred to in Article III hereof and also any other matters and things relative to such Bonds, Notes and other Obligations which are not contrary to or inconsistent with this Indenture as theretofore in effect, or to amend, modify, or rescind any such authorization, specification, or determination at any time prior to the first delivery of such Bonds, Notes and other Obligations;

(2) To add to the covenants and agreements of the Authority in this Indenture or any Supplemental Indenture, other covenants and agreements to be observed by the Authority which are not contrary to or inconsistent with this Indenture or the applicable Supplemental Indentures as theretofore in effect;

(3) To add to the limitations and restrictions in this Indenture or any Supplemental Indenture other limitations and restrictions to be observed by the Authority which are not contrary to or inconsistent with this Indenture or the applicable Supplemental Indenture as theretofore in effect;

(4) To confirm, as further assurance, any pledge under, and the subjection to any lien or pledge created or to be created by, this Indenture or any Supplemental Indenture, of the Pledged Revenues and Pledged Funds, or to grant to Owners of Bonds or Notes additional rights or enhancements on any Bond, Note, or Credit Agreement;

(5) To modify any of the provisions of this Indenture or any Supplemental Indenture in any respect whatever, provided that (i) such modification shall be, and be expressed to be, effective only after all Outstanding Bonds, Notes and other Obligations of any Series at the date of the adoption of such Indenture or Supplemental Indenture shall cease to be Outstanding Bonds, Notes and other Obligations; and (ii) such Supplemental Indenture shall be specifically referred to in the text of such Bonds, Notes and other Obligations delivered after the date of the adoption of such Supplemental Indenture and of Bonds, Notes and other Obligations issued in exchange therefor or in place thereof;

(6) To surrender any right, power or privilege reserved to or conferred upon the Authority by the terms of this Indenture, provided that the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of the Authority contained in this Indenture;

(7) To add additional elements or components to the System or Groundwater Reduction Plan as now or hereafter permitted by law;

(8) To increase the Reserve Fund Requirement for the Debt Service Reserve Fund or the Junior Lien Debt Service Reserve Fund, to provide for Debt Service Reserve Fund Surety Policies, to increase or alter the Coverage Fund Requirement, or to increase or alter the required balance in the O&M Reserve Account;

(9) To alter the Indenture to comply with the requirements of a nationally recognized rating agency in order to obtain or maintain a rating on the Bonds or Notes in a long-term debt rating category or in a high-quality, short-term or commercial paper rating category of such rating agency;

(10) To increase the interest rate or rates on the Bonds or Notes of any Series;

(11) To designate Paying Agents, Authenticating Agents, Registrars, and other agents for the Bonds or Notes of any Series;

(12) To cure any ambiguity, supply any omission, or cure or correct any defect or inconsistent provision in this Indenture;

(13) To insert such provisions clarifying matters or questions arising under this Indenture as are necessary or desirable and are not contrary to or inconsistent with this Indenture as theretofore in effect; and

(14) To modify any of the provisions of this Indenture or any Supplemental Indenture in any respect whatsoever, provided that such action shall not adversely affect the interest(s) of the owners of any Outstanding Bonds, Notes or other Obligations.

Section 1002. Supplemental Indentures Effective With Consent of Owners. In addition to Section 1001, at any time or from time to time, a Supplemental Indenture may be adopted with the consent by or on behalf of the Owners in accordance with and subject to the provisions of Article XI (including specifically Section 1107), which Supplemental Indenture shall become fully effective in accordance with its terms as provided in said Article XI.

\* \* \*

Section 1107. Special Provisions for Issuers of Credit Agreements. Any Supplemental Indenture may provide that the issuer of any Credit Agreement guaranteeing payment of the principal of and interest on any Bonds or Notes may exercise the rights of such Owners of the guaranteed Bonds or Notes with respect to consent to any amendments provided in this Article except any change in the terms of redemption, maturity or principal amount of such Bond or Note or any installment of interest thereon or any reduction in the principal amount or redemption price thereof or the rate of interest thereon.

\* \* \*

Section 1301. Defeasance.

(1) If the Authority shall pay or cause to be paid, or there shall otherwise be paid, to the Owners of all Bonds and Notes the principal or redemption price, if applicable, and interest due or to become due thereon, at the times and in the manner stipulated therein and in this Indenture and all amounts due on other Obligations are paid, as therein provided, then the pledge of the Pledged Revenues and Pledged Funds under this Indenture and all covenants, agreements and other obligations of the Authority to the Owners thereof shall thereupon cease, terminate and become void and be discharged and satisfied. In such event, upon the request of the Authority, the Fiduciaries shall pay over or deliver to the Authority all moneys or securities held by them pursuant to this Indenture which are not required for the payment of principal or redemption price, if applicable, on Bonds or Notes not theretofore surrendered for such payment, or redemption. If the Authority shall pay or cause to be paid, or there shall otherwise be paid, to the Owners of all Outstanding Bonds or Notes of a particular Series, the principal or redemption price, if applicable, and interest due or to become due thereon, at the times and in the manner stipulated therein and in this Indenture, such Bonds or Notes shall cease to be entitled to any lien, benefit or security under this Indenture, and all covenants, agreements and obligations of the Authority to the Owners of such Bonds or Notes shall thereupon cease, terminate and become void and be discharged and satisfied.

(2) Bonds, Notes and other Obligations or interest installments for the payment or redemption of which moneys shall have been set aside and shall be held in trust by the Trustee or a Paying Agent (through deposit by the Authority of funds for such payment or redemption or otherwise) at the maturity or redemption date thereof shall be deemed to have been paid within the meaning and with the effect expressed in Subsection (1) of this Section. All Outstanding Bonds, Notes and other Obligations which have been redeemed or paid pursuant to this Subsection (2) shall, prior to the maturity or redemption date thereof, be deemed to have been paid within the meaning and with the effect expressed in Subsection (1) of this Section if (i) in case any of said Bonds, Notes and other Obligations are to be redeemed on any date prior to their maturity, the Authority shall have given to the Trustee or a Paying Agent effected in form satisfactory to it a Letter of Instructions containing irrevocable instructions to give notice of redemption of such Bonds, Notes and other Obligations on said date as provided in Article IV, (ii) there shall have been deposited with the Trustee or appropriate Paying Agent either money in an amount which shall be sufficient, or Escrowed Investment Securities the principal of and interest on which without any reinvestment thereof when due will provide money which, together with the money, if any, deposited with the Trustee or appropriate Paying Agent at the same time, shall be sufficient, to pay when due the principal or redemption price, if applicable, and interest due and to become due on said Bonds, Notes and other Obligations on and prior to the redemption date or maturity date thereof, as the case may be, and (iii) in the case of Bonds only, in the event said Bonds are not to be redeemed within the next succeeding sixty (60) days, the Authority shall have given the Trustee or the appropriate Paying Agent in form satisfactory to it a Letter of Instructions containing irrevocable instructions to publish, as soon as practicable, in one or more of the Authorized Newspapers a notice to such Owners of such Bonds and mailing notice to such Owners that the deposit required by (ii) above has been made with the Trustee or Paying Agent and that said Bonds are deemed to have been paid in accordance with this Section and stating such maturity or redemption date upon which money is to be made available for the payment of the principal or redemption price, if applicable, on said Bonds. Neither Escrowed Investment Securities nor money deposited with the Trustee or a Paying Agent pursuant to this Section nor principal or interest payments on any such Escrowed Investment Securities shall be withdrawn or used for any purpose other than, and shall be held in trust for, the payment of the principal or redemption price, if applicable, and interest on said Bonds, Notes and other Obligations; provided that any cash received from such principal or interest payments on such Investment Securities deposited with the Trustee or Paying Agent, (A) to the extent such cash will not be required at any time for such purpose, shall be paid over to the Authority, or to its order, as received by the Trustee or Paying Agent, free and clear of any trust, lien, security interest, pledge or assignment securing said Bonds, Notes and other Obligations or otherwise existing under this Indenture, if all Bonds, Notes and other Obligations have been redeemed or discharged, otherwise such cash shall be deposited as Pledged Revenues and (B) to the extent such cash will be required for such purpose at a later date, shall, to the extent practicable, be reinvested in Investment Securities maturing at times and in amounts sufficient to pay when due the principal and interest to become due on said Bonds, Notes and other Obligations, on or prior to such redemption date or maturity date thereof, as the case may be, and interest earned from such reinvestments shall be paid over to the Authority, as received, or to its order, by the Trustee or appropriate Paying Agent, free and clear of any trust, lien or

pledge, if all Bonds, Notes and other Obligations have been redeemed or discharged, otherwise such cash shall be deposited as Pledged Revenues.

For the purposes of this Subsection 2, Escrowed Investment Securities shall mean and include only

(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 governing body of the Authority 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 governing body of the Authority 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.

**APPENDIX D —**  
**FORM OF BOND COUNSEL OPINION**

ALLEN BOONE HUMPHRIES ROBINSON LLP

ATTORNEYS AT LAW

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HOUSTON, TEXAS 77027  
TEL (713) 860-6400  
FAX (713) 860-6401  
abhr.com

June \_\_, 2012

WE HAVE ACTED as bond counsel for the WEST HARRIS COUNTY REGIONAL WATER AUTHORITY (the "Authority") in connection with an issue of bonds (the "Bonds") described as follows:

WEST HARRIS COUNTY REGIONAL WATER AUTHORITY WATER SYSTEM REVENUE REFUNDING BONDS, SERIES 2013, dated June 1, 2013, in the aggregate principal amount of \$\_\_\_\_\_, maturing and bearing interest all as more fully provided in the Bonds, the Indenture of Trust dated as of August 1, 2003, and the Seventh Supplemental Indenture of Trust dated as of June 1, 2013 (collectively, the "Indenture"), by and between the Authority and Regions Bank ("Trustee"). The Bonds are subject to redemption prior to maturity and may be transferred and exchanged as set out in the Bonds and in the Indenture.

WE HAVE ACTED as 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. We have not investigated or verified original proceedings, records, data or other material, but have relied solely upon the transcript of certified proceedings described in the following paragraph. We have not assumed any responsibility with respect to the financial condition or capabilities of the Authority or the disclosure thereof in connection with the offer and sale of the Bonds. Our role in connection with the Authority's Official Statement prepared for use in connection with the offer and sale of the Bonds has been limited as described therein.

IN OUR CAPACITY as Bond Counsel, we have participated in the preparation of and have examined a transcript of certified materials pertaining to the Bonds and the bonds being refunded, on which we have relied in giving our opinion. The transcript contains certified copies of certain proceedings of the Authority and of Regions Bank as the Escrow Agent (as defined in the Indenture); the report of Grant Thornton L.L.P., certified public accountants (the "Report"), verifying the sufficiency of the deposits made for defeasance of the bonds being refunded and the mathematical accuracy of certain computations of the yield on the Bonds; executed copies of the Resolution of the Authority's Board of Directors authorizing the Bonds and the Indenture; customary certificates of officials, agents and representatives of the Escrow Agent, Authority and



the Trustee; and other certified showings relating to the authorization and issuance of the Bonds and the firm banking and financial arrangements for the discharge and final payment of the bonds being refunded. We have also examined a specimen of the form of registered bond of this issue.

BASED ON SUCH EXAMINATION, IT IS OUR OPINION that:

(1) The Authority has been validly created and organized and the transcript of certified proceedings evidences complete legal authority for the execution and delivery of the Indenture and issuance of the Bonds in full compliance with the Constitution and laws of the State of Texas presently effective; and that therefore, the Bonds constitute valid and legally binding special obligations of the Authority payable solely from the sources provided therefor in the Indenture;

(2) The Bonds are secured by a lien on and pledge of Pledged Revenues, Pledged Funds and other revenues described in the Indenture (hereinafter referred to as the "Trust Estate"), and are not payable from any other properties or revenues of the Authority. The Bonds have been duly authorized, executed and delivered by the Authority, are in full force and effect and constitute legal, valid and binding special obligations of the Authority, entitled to the benefits of the Indenture.

(3) The transcript of certified proceedings evidences that firm banking and financial arrangements have been made for the discharge and final payment of the bonds being refunded pursuant to an escrow agreement entered into between the District and the Escrow Agent on or effective as of the date of delivery of the Bonds, and that therefore, such 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 escrow agreement.

THE RIGHTS OF THE OWNERS of the Bonds are subject to the applicable provisions of the federal bankruptcy laws and any other similar laws affecting the rights of creditors of political subdivisions and may be limited by general principles of equity which permit the exercise of judicial discretion. The Bonds are secured solely by a lien on and pledge of the Trust Estate as described above and do not constitute an indebtedness or general obligation of the Authority. Owners of the Bonds shall never have the right to demand payment of principal or interest out of any funds raised or to be raised by ad valorem taxation.

THE AUTHORITY HAS RESERVED THE RIGHT TO ISSUE ADDITIONAL BONDS, NOTES AND OTHER OBLIGATIONS in accordance with and subject to the restrictions contained in the Indenture, secured by a lien on and pledge of the Trust Estate on a parity with the lien securing the Bonds. The Authority also has reserved the right to issue other Authority obligations which are secured by a junior and subordinate lien on the Trust Estate and on such terms and conditions set forth in the Indenture. The

Authority has also reserved the right to issue other obligations which are not secured by the Trust Estate.

IT IS OUR FURTHER OPINION THAT:

(1) Interest on the Bonds is excludable from gross income for federal income tax purposes under existing law.

(2) Interest on the Bonds is not subject to the alternative minimum tax on individuals and corporations, except that interest on the Bonds will be included in the "adjusted current earnings" of a corporation (other than any S corporation, regulated investment company, REIT, REMIC or FASIT) for purposes of computing its alternative minimum tax liability.

In providing such opinions, we have relied on representations of the Authority, the Financial Advisor to the Authority, and the Underwriters (as defined in the Indenture) with respect to matters solely within the knowledge of the Authority, the Financial Advisor to the Authority, and the Underwriters, respectively, which we have not independently verified, and have assumed continuing compliance with the covenants in the Indenture pertaining to those sections of the Internal Revenue Code of 1986, as amended, which affect the exclusion from gross income of interest on the Bonds for federal income tax purposes. We further have relied on the Report with regard to the mathematical accuracy of certain computations. If such representations or Report are determined to be inaccurate or incomplete or the Authority fails to comply with the foregoing described covenants of the Indenture, interest on the Bonds could become includable in gross income from the date of their original delivery, regardless of the date on which the event causing such inclusion occurs.

Except as stated above, we express no opinion as to any federal, state or local tax consequences resulting from the receipt or accrual of interest on, or acquisition, ownership or disposition of, the Bonds.

Owners of the Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be 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 qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the "branch profits tax" on their effectively-connected earnings and profits (including tax-exempt interest such as interest on Bonds).

The opinions set forth above 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 these opinions to reflect any facts or circumstances that may hereafter come to our attention or to reflect any changes in any law that may hereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service (the "Service"); rather, such opinions represent our legal judgment based upon our review of existing law and in reliance upon the representations and covenants referenced above that we deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given whether or not the Service will commence an audit of the Bonds. If an audit is commenced, in accordance with its current published procedures, the Service is likely to treat the Authority as the taxpayer. We observe that the Authority has covenanted in the Indenture not to take any action, or omit to take any action within its control, that if taken or omitted, respectively, may result in the treatment of interest on the Bonds as includable in gross income for federal income tax purposes.

Very truly yours,

**APPENDIX E —  
MAP OF THE AUTHORITY**

# West Harris County Regional Water Authority Revised Voting Precincts



**DANNENBAUM**  
ENGINEERING CORPORATION



## LEGEND

- WHCRWA Municipal Utility District Boundaries
- - - - City of Houston 1999 City Limits

## WHCRWA Precincts

- |  |  |
|--|--|
| <span style="background-color: #90EE90; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 1 | <span style="background-color: #FFFF00; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 6 |
| <span style="background-color: #FFB6C1; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 2 | <span style="background-color: #FFB6C1; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 7 |
| <span style="background-color: #90EE90; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 3 | <span style="background-color: #ADD8E6; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 8 |
| <span style="background-color: #FFDAB9; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 4 | <span style="background-color: #DDA0DD; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 9 |
| <span style="background-color: #FFA500; border: 1px solid black; display: inline-block; width: 20px; height: 10px;"></span> Precinct 5 |  |

July 2012

