

OFFICIAL STATEMENT DATED JULY 17, 2012

**THE DELIVERY OF THE BONDS IS SUBJECT TO THE OPINION OF BOND COUNSEL AS TO THE VALIDITY OF THE BONDS AND OF SPECIAL TAX COUNSEL TO THE EFFECT THAT UNDER EXISTING LAW AND ASSUMING COMPLIANCE WITH COVENANTS IN THE BOND ORDINANCE, INTEREST ON THE BONDS IS EXCLUDABLE FROM GROSS INCOME OF THE OWNERS THEREOF FOR FEDERAL INCOME TAX PURPOSES AND IS NOT SUBJECT TO THE ALTERNATIVE MINIMUM TAX ON INDIVIDUALS. SEE "LEGAL MATTERS" AND "TAX EXEMPTION" HEREIN FOR A DISCUSSION OF BOND COUNSEL'S AND SPECIAL TAX COUNSEL'S OPINIONS, INCLUDING THE ALTERNATIVE MINIMUM TAX CONSEQUENCES FOR CORPORATIONS.**

*The City has designated the Bonds as "qualified tax-exempt obligations." See "TAX EXEMPTION--Qualified Tax-Exempt Obligations."*

**NEW ISSUE  
BOOK-ENTRY ONLY  
CUSIP 848625**

**Rating: None**

**CITY OF SPLENDORA, TEXAS**

(A political subdivision of the State of Texas located within Montgomery County, Texas)

**\$2,450,000**

**GENERAL OBLIGATION REFUNDING BONDS, SERIES 2012**

**Bonds Dated: August 1, 2012**

**Due: August 1, as shown on inside cover**

The \$2,450,000 General Obligation Refunding Bonds, Series 2012 (the "Bonds") are obligations solely of the City of Splendor, Texas (the "City") and are not obligations of the State of Texas; Montgomery County, Texas; or any other political subdivision or agency. See "THE BONDS--Source of and Security for Payment."

Interest on the Bonds will accrue from August 1, 2012, and will be payable February 1 and August 1 of each year, commencing February 1, 2013, and will be calculated on the basis of a 360-day year consisting of twelve 30-day months. The Bonds are issuable in the denominations of \$5,000 of principal amount or integral multiples thereof. The Bonds are initially registered solely in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company ("DTC"), New York, New York, acting as securities depository for the Bonds, until DTC resigns or is discharged. The Bonds initially will be available to purchasers in book-entry form only. So long as Cede & Co. is the registered owner of the Bonds, as nominee for DTC, the Bonds shall be payable to Cede & Co., which will in turn, remit such amount to DTC participants for subsequent disbursement to the beneficial owners of the Bonds. See "THE BONDS--Book-Entry Only System."

Principal of and interest on the Bonds are payable by BOKF, NA dba Bank of Texas, Austin, Texas or any successor paying agent/registrar (the "Paying Agent/Registrar"). Interest on the Bonds will be payable by check mailed on or before the interest payment date to registered owners shown on the records of the Paying Agent/Registrar on the fifteenth day of the month preceding each interest payment date or by such other customary banking arrangements as may be agreed upon by the Paying Agent/Registrar and the registered owner at the risk and expense of the registered owner. See "THE BONDS--Description."

SEE INSIDE COVER PAGE FOR MATURITY SCHEDULE

The Bonds, when issued, will constitute valid and legally binding obligations of the City and will be payable from the proceeds of an annual ad valorem tax, levied within the limits prescribed by law, against all taxable property within the City. See "THE BONDS--Source of and Security for Payment." The Bonds are subject to special investment considerations described herein. See "INVESTMENT CONSIDERATIONS." **Neither the State of Texas; Montgomery County, Texas; nor any political subdivision other than the City shall be obligated to pay the principal of and interest on the Bonds.**

The Bonds will be delivered when, as and if issued by the City and accepted by the underwriter listed below (the "Underwriter"), subject among other things to the approval of the initial Bonds by the Attorney General of the State of Texas and by the approval of certain legal matters by Bill Corsbie, P.C., Austin, Texas, Bond Counsel and Andrews Kurth LLP, Houston, Texas, Special Tax Counsel. Certain legal matters will be passed upon for the Underwriter by Fulbright & Jaworski L.L.P., Houston, Texas, Underwriter's Counsel. Delivery of the Bonds is expected on or about August 21, 2012 in Austin, Texas.

**SAMCO Capital Markets, Inc.**

## MATURITY SCHEDULE

**Bonds Dated: August 1, 2012**

**Due: August 1, as shown below**

<u>Maturity</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Initial Yield(a)</u>	<u>Maturity</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Initial Yield(a)</u>
2013	\$35,000	2.000%	1.50%	2019	\$250,000	2.625%	2.80%
2014	40,000	2.000%	1.75%	2020	260,000	2.900%	3.00%
2015	40,000	2.000%	2.00%	2021(b)	260,000	3.000%	3.15%
2016	240,000	2.000%	2.10%	2022(b)	270,000	3.250%	3.35%
2017	240,000	2.200%	2.35%	2023(b)	280,000	3.375%	3.50%
2018	250,000	2.400%	2.60%	2024(b)	285,000	3.500%	3.60%

(a) Initial yield represents the initial reoffering yield to the public which has been established by the Underwriter for public offerings and which subsequently may be changed. The initial yields indicated above represent the lower of the yields resulting when priced to maturity or to the first call date. Accrued interest from August 1, 2012 is to be added to the price.

(b) Bonds maturing on or after August 1, 2021, are subject to redemption prior to maturity at the option of the City, as a whole or from time to time in part, on August 1, 2020, or on any date thereafter, at par plus accrued interest from the most recent interest payment date to the date fixed for redemption. See "THE BONDS--Redemption of Bonds."

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## **USE OF INFORMATION IN OFFICIAL STATEMENT**

No dealer, broker, salesman or other person has been authorized by the City or the Underwriter (as hereinafter defined) to give any information or to make any representations other than those contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the City or the Underwriter.

This Official Statement is not to be used in connection with an offer to sell or the solicitation of an offer to buy in any state in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

All of the summaries of the statutes, orders, contracts, audited financial statements, engineering and other related reports set forth in this Official Statement are made subject to all of the provisions of such documents. These summaries do not purport to be complete statements of such provisions, and reference is made to such documents, copies of which are available from the City, c/o Bill Corsbie, P.C., 3708 Clawson, Austin, Texas 78704-7802 upon payment of duplication costs.

This Official Statement contains, in part, estimates, assumptions and matters of opinion which are not intended as statements of fact, and no representation is made as to the correctness of such estimates, assumptions or matters of opinion, or as to the likelihood that they will be realized. Any information and expressions of opinion herein contained are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the condition of the City or other matters described herein since the date hereof. The City has agreed to keep this Official Statement current by amendment or sticker to reflect material changes in the affairs of the City and, to the extent that information actually comes to its attention, the other matters described in this Official Statement until delivery of the Bonds to the Underwriter and thereafter only as specified in "PREPARATION OF THE OFFICIAL STATEMENT-- Updating the Official Statement" and "CONTINUING DISCLOSURE OF INFORMATION."

## **SALE AND DISTRIBUTION OF THE BONDS**

### **Prices and Marketability**

The delivery of the Bonds is conditioned upon the receipt by the City of a certificate executed and delivered by the Underwriter prior to delivery of the Bonds stating the prices at which a substantial amount of the Bonds of each maturity has been sold to the public. For this purpose, the term "public" shall not include any person who is a bond house, broker or similar person acting in the capacity of underwriter or wholesaler. Otherwise, the City has no understanding with the Underwriter or control regarding the reoffering yields or prices of the Bonds. Information concerning reoffering yields or prices is the sole responsibility of the Underwriter.

THE PRICES AND OTHER TERMS RESPECTING THE OFFERING AND SALE OF THE BONDS MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITER 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 THE OFFERING OF THE BONDS, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The City has no control over trading of the Bonds in the secondary market. Moreover, there is no guarantee that a secondary market will be made in the Bonds. In such a secondary market, the difference between the bid and asked price of City bonds may be greater than the difference between the bid and asked price of bonds of comparable maturity and

quality issued by more traditional governmental entities, as bonds of such entities are more generally bought, sold or traded in the secondary market.

### **Securities Laws**

No registration statement relating to 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; nor have the Bonds been registered or qualified under the securities laws of any other jurisdiction. The City 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 jurisdictions.

### **Underwriter**

The Bonds are being purchased by SAMCO Capital Markets, Inc. (the "Underwriter") pursuant to a bond purchase agreement with the City (the "Bond Purchase Agreement") at a price of \$2,385,018.40 (being the par amount of the Bonds, less original issue discount on the Bonds of \$20,759.10 and less an underwriter's discount of \$44,222.50) plus accrued interest on the Bonds to the date of delivery. The obligation of the Underwriter to purchase the Bonds is subject to certain conditions contained in the Bond Purchase Agreement.

The Underwriter may offer and sell the Bonds to certain dealers (including dealers depositing Bonds into unit investment trusts) and others at prices lower than the public offering price stated on the inside cover page hereof. The initial offering price may be changed from time to time by the Underwriter.

### **No Municipal Bond Rating**

The City has made no application for a municipal bond rating of the Certificates, nor is it expected that the City would have been successful in receiving an investment grade rating had such application been made.

## SUMMARY

The following information is a summary of certain information contained herein and is qualified in its entirety by the more detailed information and financial statements appearing elsewhere in this Official Statement, reference to which is made for all purposes. This summary should not be detached and should be used in conjunction with more complete information contained herein.

### - The City -

Issuer/Description	The City of Splendora, Texas is a political subdivision of the State of Texas, located approximately 20 miles east southeast of the City of Conroe, Texas and approximately 35 miles northeast of Houston. The City is situated in eastern Montgomery County, served by US Highway 59 and Farm Road 2090.
Authority	The rights, powers, privileges, authority and functions of the City are established by the general laws of the State of Texas. The City is a duly incorporated general law city and has adopted the powers of a Type A city in compliance with the Texas Local Government Code.

### - The Bonds -

Description	The City's \$2,450,000 General Obligation Refunding Bonds, Series 2012 (the "Bonds") are dated August 1, 2012 and interest will be calculated on the basis of a 360-day year of twelve 30-day months. The Bonds bear interest from August 1, 2012, at the rates per annum set forth on the inside cover page hereof, which interest is payable February 1, 2013 and each August 1 and February 1 thereafter until the earlier of maturity or redemption. The Bonds mature serially on August 1 in the years 2013 through 2024, both inclusive, in the principal amounts set forth on the inside cover page hereof. Bonds scheduled to mature on or after August 1, 2021, are subject to optional redemption at the option of the City on any date on or after August 1, 2020, at a price of par plus accrued interest to the date of redemption. See "THE BONDS--Description" and "--Redemption of Bonds."
Source of Payment	Principal of and interest on the Bonds are payable from the proceeds of an annual ad valorem tax, within the limits prescribed by law, levied against all taxable property within the City. The Bonds are obligations of the City and are not obligations of Montgomery County, Texas; the State of Texas; or any political subdivision other than the City. See "THE BONDS--Source of and Security for Payment."
Use of Proceeds	Proceeds of the Bonds will be used to refund the outstanding portions of the City's Certificates of Obligation, Series 2003 (the "Refunded Certificates"); and to pay the costs of issuance of the Bonds. See "THE BONDS — Use and Distribution of Bond Proceeds."
Payment Record	The City has never defaulted on the payment of any bonded indebtedness.
Qualified Tax-Exempt Obligations	The City has designated the Bonds as "qualified tax-exempt obligations" pursuant to Section 265(b) of the Internal Revenue Code of 1986, as amended, and represents that the total amount of tax-exempt bonds (including the Bonds) issued by it during the calendar year 2012 is not reasonably expected to exceed \$10,000,000. See "TAX MATTERS--Qualified Tax-Exempt Obligations."

Book-Entry Only System	The definitive Bonds will be initially registered and delivered only to Cede & Co., the nominee of DTC pursuant to the Book-Entry Only System described herein. Beneficial ownership of the Bonds may be acquired in denominations of \$5,000 or integral multiples thereof. No physical delivery of the Bonds will be made to the beneficial owners thereof. Principal and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co. and Cede & Co. will make distribution of the amounts so paid to the beneficial owners of the Bonds (see “THE BONDS--Book-Entry Only System”).
No Municipal Bond Rating	The City has made no application for a municipal bond rating for the Bonds, nor is it expected that the City would have been successful in receiving an investment grade rating for the Bonds had such application been made.
Legal Opinions	Bill Corsbie, P.C., Austin, Texas, Bond Counsel. See “LEGAL MATTERS.”
Special Tax Counsel	Andrews Kurth LLP, Houston, Texas.
Underwriter’s Counsel	Fulbright & Jaworski L.L.P., Houston, Texas
Financial Advisor	Blitch Associates, Inc., Houston, Texas.

### **RISK FACTORS**

THE PURCHASE AND OWNERSHIP OF THE BONDS ARE SUBJECT TO SPECIAL RISK FACTORS AND ALL PROSPECTIVE PURCHASERS ARE URGED TO EXAMINE CAREFULLY THE ENTIRE OFFICIAL STATEMENT WITH RESPECT TO THE INVESTMENT SECURITY OF THE BONDS, INCLUDING PARTICULARLY THE SECTION CAPTIONED "RISK FACTORS.

**- Financial Highlights -  
(Unaudited)**

2011 Taxable Assessed Valuation (100% of Market Value)	\$47,961,004	(a)
Direct Debt		
Outstanding Bonds (As of July 1, 2012)	\$3,140,000	(b)
Less: Refunded Certificates	(2,295,000)	
The Bonds	<u>2,450,000</u>	
Subtotal	\$3,295,000	
Less: Self-Supporting Debt	<u>(3,295,000)</u>	(c)
Total Direct Debt	\$0	
Estimated Overlapping Debt	<u>6,198,244</u>	(d)
Direct and Estimated Overlapping Debt	<u>\$6,198,244</u>	
Direct Debt Ratios:		
Direct Debt to Value	0.00%	
Direct & Estimated Overlapping Debt to Value	12.92%	
2011 Tax Rate per \$100 of Assessed Value		
Debt Service	\$0.0000	
Maintenance	<u>0.2797</u>	
Total	<u>\$0.2797</u>	
	<b><u>Current</u></b>	<b><u>Total</u></b>
2010 Tax Collection Percentage	95.25%	99.07%
Five-Year Average (2006/2010) Collection Percentage	95.50%	98.79%
Fund Balances as of May 31, 2012 (Cash & Investments)		
General Fund	\$51,234	
Debt Service Fund	\$266,023	
Reserve Fund	\$518,158	
Utility Fund	\$417,347	
Capital Projects Fund	\$80,234	

(a) Certified by the Montgomery County Appraisal District (the "Appraisal District"). See "TAX PROCEDURES."

(b) Exclusive of \$635,000 outstanding revenue bonds payable from net system revenues.

(c) See "THE UTILITY SYSTEM--Debt Self-Supporting."

(d) See "CITY DEBT--Estimated Overlapping Debt."

**CITY OF SPLENDORA, TEXAS**  
**\$2,450,000**  
**GENERAL OBLIGATION REFUNDING BONDS, SERIES 2012**

This Official Statement of the City of Splendor, Texas (the "City") is provided to furnish certain information with respect to the sale by the City of its \$2,450,000 General Obligation Refunding Bonds, Series 2012 (the "Bonds").

The Bonds are issued pursuant to the Texas Constitution, the general laws of the State of Texas and an ordinance authorizing the issuance of the Bonds (the "Ordinance") adopted by the City Council of the City (the "City Council"). In the Ordinance, the City Council delegated pricing of the Bonds and certain other matters to a pricing officer who will approve and execute a pricing certificate which will complete the sale of the Bonds. The Ordinance and the pricing certificate are jointly referred to herein as the "Bond Ordinance." See "THE BONDS."

This Official Statement includes descriptions of the Bonds, the Bond Ordinance and certain other information about the City. All descriptions of documents contained herein are only summaries and are qualified in their entirety by reference to each such document, copies of which may be obtained by contacting the City, c/o Bill Corsbie, P.C., 3708 Clawson, Austin, Texas 78704-7802.

**THE BONDS**

**Description**

The Bonds will mature on August 1 of the years and in principal amounts, and will bear interest from August 1, 2012, at the rates per annum, set forth on the inside cover page of this Official Statement. Interest on the Bonds will be payable on February 1, 2013, and semiannually thereafter on each August 1 and February 1 until the earlier of maturity or redemption. Principal of and interest on the Bonds will be payable to Cede & Co., as registered owner and nominee of DTC, by the paying agent/registrar, initially BOKF, NA dba Bank of Texas, Austin, Texas (the "Paying Agent/Registrar"). Cede & Co., as nominee of the Depository Trust Company ("DTC"), will make distribution of the principal and interest so paid to the beneficial owners of the Bonds. For so long as DTC shall continue to serve as securities depository for the Bonds, all transfers of beneficial ownership interest will be made by book-entry only and no investor or other party purchasing, selling or otherwise transferring beneficial ownership of the Bonds is to receive, hold or deliver any Bond certificate.

If at any time, DTC ceases to hold the Bonds as securities depository, then principal of the Bonds will be payable to the registered owner at maturity or redemption upon presentation and surrender at the principal payment office of the Paying Agent/Registrar. Interest on the Bonds will be payable by check, dated as of the interest payment date, and mailed by the Paying Agent/Registrar to the registered owners as shown on the records of the Paying Agent/Registrar at the close of business on the 15<sup>th</sup> day of the month next preceding the interest payment date (the "Record Date").

The Bonds of each maturity will be issued in fully-registered form only in the principal amount or maturity amount of \$5,000 or any integral multiple thereof.

If the specified date for any payment of principal (or redemption price) or interest on the Bonds shall be a Saturday, Sunday or legal holiday or equivalent (other than a moratorium) for banking institutions generally in the City of Houston, Texas, such payment may be made on the next succeeding date which is not one of the foregoing days without additional interest and with the same force and effect as if made on the specified date for such payments.

## Use of Proceeds

Proceeds of the Bonds will be used to refund the outstanding portion of the Certificates of Obligation, Series 2003 (the "Refunded Certificates") and to pay the costs of issuance of the Bonds. The Refunded Certificates will be called on August 22, 2012, and will consist of the following:

<u>Maturity</u>	<u>Amount</u>	<u>Rate</u>
2016	\$205,000	6.000%
2017	215,000	6.000%
2018	230,000	6.000%
2019	240,000	5.500%
2020	255,000	5.200%
2021	265,000	5.300%
2022	280,000	5.300%
2023	295,000	5.300%
2024	310,000	5.300%

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

### **Sources:**

#### Bond Proceeds

Par Amount	\$2,450,000
Original Issue Discount	(20,759)
Accrued Interest	<u>3,805</u>
Transfers from Prior Issue Debt Service Funds	<u>\$2,433,046</u>
Total Sources	

### **Uses:**

Cash Deposit for Refunding	\$2,302,374
Underwriter's Discount	44,223
Cost of Issuance	82,325
Miscellaneous	<u>4,124</u>
Total Uses	<u>\$2,433,046</u>

## Refunded Certificates

In the Bond Ordinance, the City will give instructions to provide notice to the owners of the Refunded Certificates that the Refunded Certificates will be redeemed prior to stated maturity on which date money will be made available to redeem the Refunded Certificates from money held by the Wells Fargo Bank, N.A. (the "Paying Agent for the Refunded Certificates"), contingent on the closing of the sale of the Bonds.

Proceeds from the sale of the Bonds will be used to currently refund the Refunded Certificates in order to lower the City's overall debt service and to pay costs of issuing the Bonds. The Refunded Certificates and the interest due thereon are to be paid on the date of redemption from funds to be deposited with the Paying Agent for the Refunded Certificates.

The Bond Ordinance provides that from a portion of the proceeds of the sale of the Bonds to the Underwriter, together with other legally available funds of the City, if any, the City will deposit with the Paying Agent for the Refunded Certificates, the amount necessary to accomplish the discharge and final payment of the Refunded Certificates.

By the deposit of the cash with the Paying Agent for the Refunded Certificates, the City will have effected the defeasance of the Refunded Certificates pursuant to the terms of Chapter 1207, Texas Government Code, and the order authorizing the issuance of the Refunded Certificates. In the opinion of Bond Counsel, as a result of such deposit, firm banking and financial arrangements will have been made for the discharge and final payment of the Refunded Certificates, and such Refunded Certificates will be deemed to be fully paid and no longer outstanding, except for the purpose of being paid from the funds deposited with the Paying Agent for the Refunded Certificates.

### **Book-Entry-Only System**

*This section describes how ownership of the Bonds are to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by The Depository Trust Company ("DTC"), New York, New York, while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The City, the Financial Advisor and the Underwriter believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.*

*The City cannot and does not give any assurance that (1) DTC will distribute payments of debt service on the Bonds, or redemption or other notices, to DTC Participants, (2) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.*

DTC 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 certificate will be issued for the Bonds, in the aggregate principal amount of such issue, 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, corporate and municipal debt issues, and money market instrument 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 a 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 companies 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 DTC Participants, which will receive a credit for such purchases 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 or 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 interest 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 the 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 nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds and principal and interest 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 City or Paying Agent/Registrar, 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 nor its nominee, Paying Agent/Registrar or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds and principal and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or Paying Agent/Registrar, disbursement of such payments to Direct Participants shall 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 a securities depository with respect to the Bonds at any time by giving reasonable notice to the City or Paying Agent/Registrar. Under such circumstances, in the event that a successor securities depository is not obtained, Bonds are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bonds 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 City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

### **Registration and Transfer**

The Bonds will be transferable only on the bond register kept by the Paying Agent/Registrar upon surrender and reissuance. The Bonds are exchangeable for an equal aggregate principal of Bonds of the same maturity and of any authorized denomination upon surrender of the Bonds to be exchanged at the principal office of the Paying Agent/Registrar in Austin, Texas. No service charge will be made for any registration, transfer or exchange of Bonds, but the City or the Paying Agent/Registrar may require payment of a sum sufficient to cover any tax or governmental charge payable in connection therewith. Neither the City nor the Paying Agent/Registrar is required to issue, transfer or exchange any Bond during the period beginning at the opening of business on a Record Date and ending at the close of business on the next succeeding interest payment date or to transfer or exchange any Bond selected for redemption, in whole or in part, beginning 15 calendar days prior to the date of the first mailing of any notice of redemption and ending at the close of business on the date of such mailing, or to transfer or exchange any Bond called for redemption during the thirty (30) day period prior to the date fixed for redemption of such Bond.

### **Redemption of Bonds**

The City reserves the right, at its option, to redeem the Bonds maturing on or after August 1, 2021, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof on August 1, 2020, or any date thereafter, at the par value thereof plus accrued interest to the date fixed for redemption. If less than all of the Bonds are to be redeemed, the Paying Agent/Registrar shall select by lot those Bonds to be redeemed.

At least thirty (30) days prior to the date fixed for any such redemption a written notice of such redemption shall be given to the registered owner of each Bond or a portion thereof being called for redemption by depositing such notice in the United States mail, first class, postage prepaid, addressed to each such registered owner at his address shown on the registration books of the Paying Agent/Registrar; provided, however, that the failure to receive such notice shall not affect the validity or effectiveness of the proceedings for the redemption of any Bond. By the date fixed for any such redemption due provision shall be made with the Paying Agent/Registrar for the payment of the required redemption price for the Bonds or the portions thereof which are to be so redeemed, plus accrued interest to the date fixed for redemption. If a portion of any Bond shall be redeemed, a substitute Bond having the same maturity date, bearing interest at the same rate, in any integral multiple of \$5,000, and in aggregate principal amount equal to the unredeemed position thereof, will be issued to the registered owner upon the surrender of the Bonds being redeemed, at the expense of the City, all as provided for in the Bond Ordinance.

### **Ownership**

The City, the Paying Agent/Registrar and any agent of either may treat the person in whose name any Bond is registered as the absolute owner of such Bond for the purpose of receiving payment of the principal and the interest thereon, and for all other purposes, whether or not such Bond is overdue. Neither the City, the Paying Agent/Registrar nor any agent of either shall be bound by any notice or knowledge to the contrary. All payments made to the person deemed to be the owner of any Bond in accordance with the Bond Ordinance shall be valid and effective and shall discharge the liability of the City and the Paying Agent/Registrar for such Bond to the extent of the sums paid.

### **Source of and Security for Payment**

The Bonds are payable as to principal and interest from the proceeds of a continuing, direct, annual ad valorem tax within the limits prescribed by law, levied against all taxable property located within the City. In the Bond Ordinance, the City covenants to levy annually a tax sufficient in amount to pay principal of and interest on the Bonds, full allowance being made for delinquencies and costs of collection. Collected taxes will be placed in the City's Debt Service Fund and used solely to pay principal and interest on the Bonds and on any additional bonds or certificates of obligation payable from taxes which have been or may be issued. See "Issuance of Additional Debt" below.

Certificates of obligation are further payable from and secured by a subordinate lien on and pledge of net revenues from the operation of the City's water and sewer systems (the "System").

The City does not anticipate the necessity of collecting ad valorem taxes for payment of the Bonds and expects that debt service on the Bonds and other outstanding general obligation debt of the City will be paid exclusively from net revenues of the System. See "THE UTILITY SYSTEM—Certificates Self-Supporting."

### **Replacement of Paying Agent/Registrar**

Provision is made in the Bond Ordinance for the replacement of the Paying Agent/Registrar. If the Paying Agent/Registrar is replaced by the City, the new paying agent/registrar shall act in the same capacity as the previous Paying Agent/Registrar. In order to act as Paying Agent/Registrar for the Bonds, any paying agent/registrar selected by the City shall be a national or state banking institution, organized and doing business under the laws of the United States of America or of any State, authorized under such laws to exercise trust powers, and subject to supervision or examination by federal or state authority.

### **Outstanding Debt**

In addition to debt issued by the City that have been retired or refunded, the City has previously issued \$2,155,000 Utility System Revenue Refunding Bonds, Series 2002 (the "Series 2002 Revenue Bonds"); \$2,295,000 Certificates of Obligation, Series 2003 (the "Series 2003 Certificates"); and \$905,000 Certificates of Obligation, Series 2009 (the "Series 2009 Certificates").

As of July 1, 2012, \$635,000 in aggregate principal amount of the Series 2002 Revenue Bonds; \$2,295,000 of the Series 2003 Certificates; and \$845,000 of the Series 2009 Certificates remain outstanding (collectively, the "Outstanding Debt"). The Bonds will refund all of the Series 2003 Certificates. The City has timely made payments due on the Outstanding Debt.

### **Issuance of Additional Debt**

The City may issue additional certificates of obligation bonds to provide for capital improvements.

### **Defeasance**

The Bond Ordinance provides that the obligation of the City to make money available to pay the principal of and interest on the Bonds may be terminated by the deposit of money and/or non-callable direct or indirect obligations of the United States of America, sufficient for such purpose, in the manner described in the Bond Ordinance.

### **Mutilated, Lost, Stolen or Destroyed Bonds**

The City has agreed to replace mutilated, destroyed, lost or stolen Bonds upon surrender of the mutilated Bonds to the Paying Agent/Registrar, or receipt of satisfactory evidence of such destruction, loss or theft, and receipt by the City and Paying Agent/Registrar of security or indemnity as may be required by either of them to hold them harmless. The City may require payment of taxes, governmental charges and other expenses in connection with any such replacement.

### **Amendments to the Bond Ordinance**

The City may, without the consent of or notice to any registered owners, amend the Bond Ordinance in any manner not detrimental to the interests of the registered owners, including the curing of any ambiguity, inconsistency or formal defect or omission therein. In addition, the City may, with the written consent of the registered owners of a majority in aggregate principal amount of the Bonds then outstanding affected thereby, amend, add to or rescind any of the provisions of the Bond Ordinance; provided that, without the consent of the registered owners of all of the Bonds affected, no such amendment, addition or rescission may (a) extend the time or times of payment of the principal of and

interest (or accrual of interest) on the Bonds, or reduce the principal amount thereof or the rate of interest thereon or in any other way modify the terms of payment of the principal of or interest on the Bonds, (b) give preference of any Bond over any other Bond, or (c) extend any waiver of default to subsequent defaults. In addition, a state, consistent with federal law, may in the exercise of its police power make such modifications in the terms and conditions of contractual covenants relating to the payment of indebtedness of a political subdivision as are reasonable and necessary for attainment of an important public purpose.

### **Registered Owners' Remedies and Effects of Bankruptcy**

The Bond Ordinance does not provide for the appointment of a trustee to represent the interests of the Bond holders upon any failure of the City to perform in accordance with the terms of the Bond Ordinance or upon any other condition and, in the event of any such failure to perform, the registered owners would be responsible for the initiation and cost of any legal action to enforce performance of the Bond Ordinance. Furthermore, the Bond Ordinance does not establish specific events of default with respect to the Bonds and, under State law, there is no right to the acceleration of maturity of the Bonds upon the failure of the City to observe any covenant under the Bond Ordinance. A registered owner of Bonds could seek a judgment against the City if a default occurred in the payment of principal of or interest on any such Bonds; however, such judgment could not be satisfied by execution against any property of the City and a suit for monetary damages could be vulnerable to the defense of sovereign immunity. A registered owner's only practical remedy, if a default occurs, is a mandamus or mandatory injunction proceeding to compel the City to levy, assess and collect an annual ad valorem tax sufficient to pay principal of and interest on the Bonds as it becomes due or perform other material terms and covenants contained in the Bond Ordinance. In general, Texas courts have held that a writ of mandamus may be issued to require a public official to perform legally imposed ministerial duties necessary for the performance of a valid contract, and Texas law provides that, following their approval by the Attorney General and issuance, the Bonds are valid and binding obligations for all purposes according to their terms. However, the enforcement of any such remedy may be difficult and time consuming and a registered owner could be required to enforce such remedy on a periodic basis.

### **Bankruptcy Limitation to Registered Owners' Rights**

The enforceability of the rights and remedies of the Registered Owners may be limited by laws relating to bankruptcy, reorganization or other similar laws of general application affecting the rights of creditors of political subdivisions such as the City. Subject to the requirements of Texas law, the City may voluntarily proceed under Chapter 9 of the Federal Bankruptcy Code, 11 U.S.C. Sections 901-946, if the City: (1) is generally authorized to file for federal bankruptcy protection by State law; (2) is insolvent or unable to meet its debts as they mature; (3) desires to effect a plan to adjust such debt; and (4) has either obtained the agreement of or negotiated in good faith with its creditors or is unable to negotiate with its creditors because negotiation is impracticable.

If the City decides in the future to proceed voluntarily under the Federal Bankruptcy Code, the City would develop and file a plan for the adjustment of its debts, and the Bankruptcy Court would confirm the City's plan if: (1) the plan complies with the applicable provisions of the Federal Bankruptcy Code; (2) all payments to be made in connection with the plan are fully disclosed and reasonable; (3) the City is not prohibited by law from taking any action necessary to carry out the plan; (4) administrative expenses are paid in full; and (5) the plan is in the best interests of creditors and is feasible. If such a plan were confirmed by the bankruptcy court, it could, among other things, affect a Registered Owner by reducing or eliminating the amount of indebtedness, deferring or rearranging the debt service schedule, reducing or eliminating the interest rate, modifying or abrogating collateral or security arrangements, substituting (in whole or in part) other securities, and otherwise compromising and modifying the rights and remedies of such Registered Owner's claim against the City.

### **Legal Investment and Eligibility to Secure Public Funds in Texas**

Pursuant to Chapter 1201, Texas Government Code, the Bonds, whether rated or unrated, are (a) legal investments for banks, trust companies, building and loan associations, savings and loan associations, insurance companies of all kinds and types, fiduciaries, and trustees, and (b) legal investments and lawful security for the public funds of the State, and

all agencies, subdivisions, and instrumentalities of the State, including all counties, cities, towns, villages, school districts, and other political subdivisions or public agencies of the State of Texas. The Bonds are also eligible under the Public Funds Collateral Act, Chapter 2257, Texas Government Code, to secure deposits of public funds of the State of Texas or any political subdivision or public agency of the State of Texas and are lawful and sufficient 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 a requirement consistent with such act that the Bonds have a rating of not less than “A” or its equivalent to be legal investments for such entity’s funds. The City makes no representation that the Bonds will be acceptable to banks, savings and loan associations or public entities for investment purposes or to secure deposits of public funds. The City has made no investigation of other laws, regulations or investment criteria which might apply to or otherwise limit the suitability of the Bonds for investment or collateral purposes. Prospective purchasers are urged to carefully evaluate the investment quality of the Bonds as to the suitability of the Bonds for investment or collateral purposes.

**THE CITY**

**Mayor and City Council**

Policy-making functions are the responsibility of and are vested in the Mayor and City Council for the City. The Mayor and five Council members are elected and serve two year staggered terms. The next City-wide general election will be held in November of 2012. The Mayor is entitled to vote only in the event of a tie and has power to veto Council action. Members of the Council are described below:

<u><i>Name</i></u>	<u><i>Position</i></u>	<u><i>Term Expires</i></u>
Dorothy Welch	Mayor	2013
L. Leon Ward	Councilperson	2013
Lisa Carr	Councilperson	2013
Fred Atkins, Jr.	Councilperson	2012
Dottie Bruner	Councilperson	2012
Buck Clendennen	Councilperson	2012

**Description of the City**

The City of Splendora, Texas is a political subdivision of the State of Texas, located approximately 20 miles east southeast of the City of Conroe, Texas and approximately 35 miles northeast of Houston. The City is situated in eastern Montgomery County, served by US Highway 59 and Farm Road 2090. With an estimated population of 1,374, the City’s economy is based on lumber and oil production; government and services; and as a part of the Houston Metropolitan Area.

**Administration**

The Council enacts local legislation, adopts budgets and determines policies. Members of the administrative staff are described below:

***City Secretary*** - Danna Welter serves as City Secretary for the City.

***City Attorney*** - Leonard Schneider serves as City Attorney for the City.

In addition to those directly employed by the City, the City has retained several consultants to perform professional services in connection with the independent auditing of its books and records and other City activities. Several of these consultants are identified below:

Consulting Engineer - The City has employed Bleyl & Associates, Conroe, Texas as consulting engineers (the "Engineer").

Auditor - The City's annual financial statements as of September 30, 2011(see "APPENDIX A–Financial Statements"), were audited by Hereford, Lynch, Sellars & Kirkham, Cleveland, Texas.

Financial Advisor - Blich Associates, Inc. serves as Financial Advisor to the City.

Bond Counsel - The City has employed Bill Corsbie, P.C., Austin, Texas, as Bond Counsel in connection with the issuance of the Bonds.

### CITY DEBT

#### Debt Statement

2011 Taxable Assessed Valuation (100% of Market Value)	\$47,961,004	(a)
Direct Debt		
Outstanding Bonds (As of July 1, 2012)	\$3,140,000	(b)
Less: Refunded Certificates	(2,295,000)	
The Bonds	<u>2,450,000</u>	
Subtotal	\$3,295,000	
Less: Self-Supporting Debt	<u>(3,295,000)</u>	(c)
Total Direct Debt	\$0	
Estimated Overlapping Debt	<u>6,198,244</u>	(d)
Direct and Estimated Overlapping Debt	<u>\$6,198,244</u>	
Direct Debt Ratios:		
Direct Debt to Value	0.00%	
Direct & Estimated Overlapping Debt to Value	12.92%	
Fund Balances as of May 31, 2012 (Cash & Investments)		
General Fund	\$51,234	
Debt Service Fund	\$266,023	
Reserve Fund	\$518,158	
Utility Fund	\$417,347	
Capital Projects Fund	\$80,234	

(a) Certified by the Montgomery County Appraisal District (the "Appraisal District"). See "TAX PROCEDURES."

(b) Exclusive of \$635,000 outstanding revenue bonds payable from net system revenues.

(c) See "THE UTILITY SYSTEM–Debt Self-Supporting."

(d) See "Estimated Overlapping Debt," below.

### Estimated Overlapping Debt

The following table indicates the indebtedness, defined as outstanding bonds payable from ad valorem taxes, of governmental entities within which the City is located and the estimated percentages and amounts of such indebtedness attributable to property within the City. This information is based upon data secured from the individual jurisdiction and/or the Texas Municipal Reports. Such figures do not indicate the tax burden levied by the applicable taxing jurisdictions for operation and maintenance or for other purposes. See "TAX DATA--Estimated Overlapping Taxes."

<u><i>Jurisdiction</i></u>	<u><i>Debt As Of July 1, 2012</i></u>	<u><i>Overlapping Percent</i></u>	<u><i>Overlapping Amount</i></u>
Lone Star College District	\$509,610,000	0.040%	\$203,844
Montgomery County	452,950,000	0.137%	620,542
Splendora Independent School District	42,558,393	13.106%	<u>5,577,703</u>
Estimated Overlapping Debt			\$6,198,244
The City (All debt self-supporting)			<u>0</u>
Total Direct & Estimated Overlapping Debt			<u><u>\$6,198,244</u></u>

See "THE UTILITY SYSTEM--Debt Self-Supporting."

**Debt Service Schedule**

The following sets forth the debt service requirements on the City's Outstanding Debt and on the Bonds. (Note: Totals may not add due to rounding)

<u>Year</u>	<u>Outstanding Debt Service (a)</u>	<u>Refunded Debt Service</u>	<u>The Bonds Principal</u>	<u>The Bonds Interest</u>	<u>The Bonds Total D/S</u>	<u>Grand Total Debt Service</u>
2012	\$425,910	(\$63,205)				\$362,705
2013	424,660	(126,410)	\$35,000	68,483	103,483	401,733
2014	422,910	(126,410)	40,000	67,783	107,783	404,283
2015	425,535	(126,410)	40,000	66,983	106,983	406,108
2016	426,385	(325,260)	240,000	66,183	306,183	407,308
2017	425,410	(322,660)	240,000	61,383	301,383	404,133
2018	423,560	(324,310)	250,000	56,103	306,103	405,353
2019	426,310	(320,810)	250,000	50,103	300,103	405,603
2020	424,080	(322,580)	260,000	43,540	303,540	405,040
2021	426,178	(318,928)	260,000	36,000	296,000	403,250
2022	427,110	(319,485)	270,000	28,200	298,200	405,825
2023	426,998	(319,248)	280,000	19,425	299,425	407,175
2024	<u>425,840</u>	<u>(318,215)</u>	<u>285,000</u>	<u>9,975</u>	<u>294,975</u>	<u>402,600</u>
	<u>\$5,530,885</u>	<u>(\$3,333,930)</u>	<u>\$2,450,000</u>	<u>\$574,158</u>	<u>\$3,024,158</u>	<u>\$5,221,113</u>

Average Annual Debt Service (2013/2024) \$404,868  
 Maximum Annual Debt Service (2016) \$407,308

(a) Includes revenue bonds and certificates of obligation. See "THE SYSTEM–Debt Self Supporting."

## Historical Operations of the General Fund

The following statement sets forth in condensed form the historical operations of the City's General Fund. Such information has been prepared based upon information obtained from the City's audited financial statements (except for the eight months ended May 31, 2012, which was extracted from unaudited City records) and other information provided by the City. Reference is made to such statements for further and complete information.

	<i>10/1/11 to</i>	<i>Fiscal Years Ended September 30,</i>				
	<u>5/31/12(a)</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Revenues						
Fines & Penalties	\$97,923	\$142,266	\$144,708	\$155,596	\$165,672	\$206,800
Franchise Tax	5,302	62,689	62,232	55,219	57,113	54,841
Ad Valorem Tax	124,078	127,701	124,824	107,986	95,402	90,418
Sales Tax	141,697	212,579	186,488	212,347	190,317	169,550
Other Revenues	<u>18,880</u>	<u>38,726</u>	<u>19,495</u>	<u>33,347</u>	<u>30,905</u>	<u>23,511</u>
Total Revenues	\$387,879	\$583,961	\$537,747	\$564,495	\$539,409	\$545,120
Expenditures						
General Gov/City Admin	\$68,787	\$90,652	\$68,379	\$91,382	\$87,081	\$82,289
Police Department	380,452	504,089	445,182	422,986	444,500	339,310
Streets/Other	28,941	14,560	55,683	9,633	6,997	10,436
Capital Outlay	<u>0</u>	<u>0</u>	<u>22,194</u>	<u>95,043</u>	<u>57,134</u>	<u>0</u>
Total Expenses	<u>\$478,181</u>	<u>\$609,301</u>	<u>\$591,438</u>	<u>\$619,044</u>	<u>\$595,712</u>	<u>\$432,035</u>
Net Revenues	(\$90,302)	(\$25,340)	(\$53,691)	(\$54,549)	(\$56,303)	\$113,085
Other Financing Sources						
Transfers In (Out)	\$40,000	\$30,000	\$0	\$101,247	\$0	\$0
Debt Service		(11,092)	(31,247)	(31,247)	(28,962)	0
Proceeds From Loan		0	0	31,175	57,134	0
Fund Balance, Oct 1		<u>\$130,727</u>	<u>\$215,665</u>	<u>\$169,039</u>	<u>\$197,170</u>	<u>\$84,085</u>
Fund Balance, Sept 30		<u>\$124,295</u>	<u>\$130,727</u>	<u>\$215,665</u>	<u>\$169,039</u>	<u>\$197,170</u>
Cash & Investments, Sept 30		<u>\$104,836</u>	<u>\$128,067</u>	<u>\$225,972</u>	<u>\$176,682</u>	<u>\$200,175</u>

(a) Unaudited; prepared from City records.

## THE UTILITY SYSTEM

### Regulation

The water, wastewater and drainage facilities (the "System") financed by the City have been designed in accordance with accepted engineering practices and the requirements of certain governmental agencies having regulatory or supervisory jurisdiction over the construction and operation of such facilities including, among others, the Texas Commission on Environmental Quality ("TCEQ"), Montgomery County and the Lone Star Groundwater Conservation District. During construction, facilities are subject to inspection by the City's Engineer, the foregoing governmental agencies and by the TCEQ.

Operation of the System is subject to regulation by, among others, the Environmental Protection Agency, the TCEQ and Montgomery County. Withdrawal of groundwater and the issuance of water well permits is subject to the regulatory authority of the Lone Star Groundwater Conservation District. In many cases, regulations promulgated by these agencies have become effective only recently and are subject to further development and revision.

### General Description

The City owns and operates its water, wastewater and gas systems. The water system includes supply, treatment, storage, pumping and control facilities and a distribution network. The wastewater system includes an existing wastewater treatment facility and a wastewater collection system, comprised of conventional gravity flow sewers, combined with several wastewater lift stations. The gas system includes supply and distribution facilities.

*Water System...*The City utilizes groundwater from the Evangeline Aquifer as the supply for the City. The City has a total of three water wells with a combined pumping capacity of 1,716 gallons per minute ("gpm") to meet their water demands, which capacity is sufficient to meet an estimated 2,754 equivalent connections. There are two main water supply plants that consist of supply wells, ground storage tankage and booster pumps. US 59 Plant No. 3 includes two of the three wells, a 200,000 gallon elevated storage tank and an 80,000 gallon ground storage tank and two 500 gpm booster pumps. Old US 59 Plant No. 2 includes the third well, a 125,000 gallon ground storage tank, and two 600 gpm booster pumps. A 150,000 gallon elevated storage tank is located behind City Hall.

*Wastewater System...*The existing wastewater treatment plant has a permitted capacity of 84,000 gallons per day ("gpd"). Eleven lift stations serve all but a few existing residences and businesses within the City limits.

*Gas System...*The existing gas system supplies natural gas to approximately 270 customers.

### Utility Rates

On March 16, 2009, the City took action to increase its water and sewer rates as follows:

#### *-Water-*

##### ***Inside City Limits (a)***

First 3,000 gallons	\$22.00 Minimum Charge
Next 12,000 gallons	\$3.00/thousand gallons
Over 15,000 gallons	\$3.50/thousand gallons

(a) The above rates are for residential customers. Non-residential customers pay a higher minimum charge based on meter size. Outside City limit customers pay a minimum charge of \$25.00 and an additional \$1.00 per thousand gallons over the 3,000 minimum.

**-Sewer-**

**Inside City Limits (a)**

First 1,000 gallons	\$5.00 Minimum Charge
Over 1,000 gallons	\$3.00/thousand gallons

(a) The above rates are for residential customers. Non-residential and outside City limit customers pay a \$10.00 minimum charge and \$3.90 per thousand gallons over the 3,000 minimum

The City is considering an increase in water and sewer rates in connection with the issuance of up to \$1.5 million certificates of obligation, such rates to provide for at least sufficient funds to cover debt service on such certificates of obligation.

**Debt Self-Supporting**

It is the City's intention to pay debt service on the Certificates exclusively from net revenues of the water and sewer systems remaining after the City's outstanding revenue bond debt service has been satisfied.

## Utility System Operations

The following statement sets forth in condensed form the historical operations of the City's utility systems. Accounting principles customarily employed in the determination of net revenue available for coverage of debt service have been observed and in all instances exclude depreciation, payments of debt service and expenditures identified as capital. Such information has been prepared based upon information obtained from the City's audited financial statements, except for the eight month period ended May 31, 2012, which was prepared from unaudited City records

	<i>10/1/11 to</i>	<i>Fiscal Year Ended September 30,</i>				
	<u>5/31/12(a)</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>REVENUES</b>						
Water Sales	\$973,482	\$1,550,355	\$1,282,351	\$1,222,730	\$1,138,237	\$1,043,741
Sewer Collections	84,831	130,476	108,473	89,004	99,215	95,583
Gas Sales	84,628	125,265	133,305	158,931	129,617	116,283
Interest Earnings	953	2,915	4,334	9,460	17,152	37,408
Miscellaneous	<u>2,044</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>39,850</u>
Total Revenues	\$1,145,938	\$1,809,011	\$1,528,463	\$1,480,125	\$1,384,221	\$1,332,865
<b>EXPENSES</b>						
Administration	\$201,191	\$297,345	\$305,866	\$292,602	\$279,006	\$195,693
Water Department	423,084	638,217	481,357	482,240	463,047	404,662
Sewer Department	88,009	135,240	98,641	72,135	109,986	79,293
Gas Department	<u>39,740</u>	<u>60,833</u>	<u>96,453</u>	<u>90,964</u>	<u>107,926</u>	<u>113,103</u>
Total Expenses	<u>\$752,025</u>	<u>\$1,131,635</u>	<u>\$982,317</u>	<u>\$937,941</u>	<u>\$959,965</u>	<u>\$792,751</u>
NET REVENUES	<u>\$393,913</u>	<u>\$677,376</u>	<u>\$546,146</u>	<u>\$542,184</u>	<u>\$424,256</u>	<u>\$540,114</u>
<b>OTHER CHARGES</b>						
Depreciation		(\$273,104)	(\$232,670)	(\$226,697)	(\$228,330)	(\$238,604)
Capital Outlay	(215,559)	0	0	0	0	(84,715)
Grant Income (Expense)	136,969	(549)	230,408	(44,542)	(30,315)	0
Intergovernmental		248,443	0	0	0	0
Debt Service Interest	(106,205)	(230,882)	(224,940)	(195,364)	(197,285)	(205,568)
Transfers In (Out)	<u>(40,000)</u>	<u>(30,000)</u>	<u>0</u>	<u>(8,448)</u>	<u>0</u>	<u>0</u>
Net Change for Year		\$391,284	\$318,944	\$67,133	(\$31,674)	\$11,227
Retained Earnings, Oct 1		2,518,205	2,199,261	2,132,128	2,163,802	2,152,575
Retained Earnings, Sept 30		<u>\$2,909,489</u>	<u>\$2,518,205</u>	<u>\$2,199,261</u>	<u>\$2,132,128</u>	<u>\$2,163,802</u>
Cash & Invest, Sept 30 (b)		<u>\$553,012</u>	<u>\$346,774</u>	<u>\$987,726</u>	<u>\$94,288</u>	<u>\$80,644</u>
% of Operating Expenses		48.87%	35.30%	105.31%	9.82%	10.17%

(a) Unaudited; extracted from City records.

(b) Net of customer deposits.

## **TAX PROCEDURES**

### **Authority To Levy Taxes**

The City Council is authorized to levy an annual ad valorem tax, within the limits prescribed by law, on all taxable property within the City in sufficient amount to pay the principal of and interest on the City's Outstanding Bonds, the Bonds and any additional bonds payable from taxes which the City may hereafter issue, and to pay the expenses of assessing and collecting such taxes. The City Council also is authorized to levy and collect annual ad valorem taxes for the administration, operation and maintenance of the City and its properties and for the payment of certain contractual obligations other than bonds if such taxes are authorized by vote of the City's electors at an election.

### **Exempt Property**

Except for certain exemptions provided by Texas law, all real property, tangible personal property held or used for the production of income, mobile homes, and certain categories of intangible personal property with a tax situs in the City are subject to taxation by the City; however, no effort is expected to be made to levy taxes against tangible or intangible personal property not devoted to commercial or industrial use. Principal categories of exempt real property include property owned by the State of Texas or its political subdivisions if the property is used for public purposes; property exempt from ad valorem taxation by federal law; non-profit cemeteries; certain household goods, family supplies and personal effects; and certain property owned by qualified charitable, religious, veterans, youth, fraternal, or educational organizations. Property owned by a disabled veteran or by the spouse or certain children of a deceased disabled veteran or a veteran who died while on active duty is exempt to between \$5,000 and \$12,000 depending on the disability rating of the veteran. State law further mandates a complete exemption for the residential homestead of disabled veterans determined to be 100% disabled by the U.S. Department of Veterans Affairs. Additionally, pursuant to a constitutional amendment approved by the voters during the November 8, 2011 statewide election and effective as of January 1, 2012, subject to certain conditions, the surviving spouse of a disabled veteran who is entitled to an exemption for the full value of the veteran's residence homestead is also entitled such exemption on the same property to which the disabled veteran's exemption applied.

If approved by the City Council or through a process of petition and referendum by the City's voters, residence homesteads of certain persons who are disabled or at least 65 years old are exempt to the extent of \$3,000 or such higher amount, as the City Council or the City's voters may approve. The City's tax assessor is authorized by statute to disregard exemptions for the disabled and elderly if granting the exemption would impair the City's obligation to pay tax-supported debt incurred prior to adoption of the exemption by the City. The City currently grants a \$25,000 homestead exemption to persons who are 65 years of age or older and a \$25,000 homestead exemption to disabled homestead owners.

The City Council also may exempt up to 20% of the market value of residential homesteads from ad valorem taxation. Such exemption would be in addition to any other applicable exemptions provided by law. However, if ad valorem taxes have previously been pledged for the payment of debt and the granting of the homestead exemption would impair the obligation or the contract by which the debt was created, then the City Council may continue to levy and collect taxes against the exempt value of the homesteads until the debt is discharged. The City Council currently grants no percentage homestead exemption.

Montgomery County may designate all or part of the area within the City as a reinvestment zone, and the City, Montgomery County, Splendora Independent School District, or Lone Star College District may thereafter enter into tax abatement agreements with owners of real property within the zone. The tax abatement agreements may exempt from ad valorem taxation by the applicable taxing jurisdiction, for a period of up to 10 years, all or any part of any increase in the assessed valuation of property covered by the agreement over its assessed valuation in the year in which the agreement is executed, on the condition that the property owner make specified improvements or repairs to the property in conformity with a comprehensive plan. None of the area within the City has been designated as a reinvestment zone to date.

## **Appraisal of Taxable Property**

The Texas Property Tax Code (the "Property Tax Code") establishes an appraisal district and an appraisal review board in each county of the State of Texas. The appraisal district is governed by a board of directors which is elected by the governing bodies of cities, towns, the county, school districts and, if entitled to vote, the conservation and reclamation districts that participate in the appraisal district, and of the county. The board of directors selects a chief appraiser to manage the appraisal office of the appraisal district. All taxing units within Montgomery County, including the City, are included in the Montgomery County Appraisal District (the "Appraisal District"). The Appraisal District is responsible for appraising property within the City, subject to review by the Montgomery County Appraisal Review Board (the "Appraisal Review Board"). The appraisal roll approved by the Appraisal Review Board must be used by the City in establishing its tax rolls and tax rate. The valuation and assessment of taxable property within the City is governed by the Property Tax Code.

## **Assessment and Levy**

Generally, all taxable property in the City (other than any qualifying agricultural or timber land) must be appraised at 100% of market value as of January 1 of each tax year, subject to review and approval by the Appraisal Review Board. However, houses held for sale by a developer or builder which remain unoccupied, are not leased or rented, and produce no income are required to be assessed at the price for which they would sell as a unit to a purchaser who would continue the owner's business. Valuation of houses at inventory level in future years could reduce the assessed value of developer and builder house inventory within the City. Certain land may be appraised at less than market value under the Property Tax Code. Upon application of a landowner, land which qualifies as "open-space land" is appraised based on the category of land, agriculture and hunting or recreational leases. Once an appraisal roll is prepared and approved by the Appraisal Review Board, it is used by the City in establishing its tax rate.

The Property Tax Code requires the Appraisal District to implement a plan for periodic reappraisal of property to update appraised values. The plan must provide for appraisal of all real property in the Appraisal District at least once every three (3) years. It is not known what frequency of reappraisal will be utilized by the Appraisal District or whether reappraisals will be conducted on a zone or county-wide basis. The City at its expense has the right to obtain from the Appraisal District a current estimate of appraised values within the City or an estimate of any new property or improvements within the City. While such current estimate of appraised values may serve to indicate the rate and extent of growth of taxable values within the City, it cannot be used for establishing a tax rate within the City until such time as the Appraisal District chooses formally to include such values on its appraisal roll.

The chief appraiser must give written notice to each owner if the appraised value of his property is greater than it was in the preceding year, if the appraised value of the property is greater than the value rendered by the property owner, or if the property was not on the appraisal roll in the preceding year. In addition, the chief appraiser must give written notice to each property owner whose property was reappraised in the current year or if ownership of the property changed during the preceding year. The Appraisal Review Board has the ultimate responsibility for determining the value of all taxable property within the City; however, any owner who has timely filed notice with the Appraisal Review Board may appeal the final determination by the Appraisal Review Board by filing suit in Texas district court. Prior to such appeal and prior to the delinquency date, however, the owner must pay the tax due on the amount of value of the property involved that is not in dispute or the amount of tax paid in the prior year, whichever is greater, or the amount of tax due under the order from which the appeal is taken. In the event of such suit, the value of the property is determined by the court, or a jury if requested by any party. Additionally, the City is entitled to challenge certain matters before the Appraisal Review Board, including the level of appraisals of a certain category of property, the exclusion of property from the appraisal records, or the grant in whole or in part of a partial exemption. The City may not, however, protest a valuation of individual property.

The rate of taxation is set by the City Council of the City based upon the valuation of property within the City as of the preceding January 1 and based upon the amount required to be raised for debt service, maintenance purposes and authorized contractual obligations.

The City is responsible for the levy and collection of its taxes and will continue to do so unless the City Council or the qualified voters of the City or of Montgomery County at an election held for such purpose determines to transfer such functions to the Appraisal District or another taxing unit.

The City may under certain circumstances be required to advertise and hold a public hearing within the City on a proposed tax rate before the City Council can hold a public meeting to vote on the tax rate. If the tax rate adopted exceeds by more than 8% the rate needed to pay debt service and certain contractual obligations and to produce, when applied to the property which was on the prior year's roll, the prior year's total taxes levied for purposes other than debt service and such contractual obligations, such excess portion of the levy may, subject to constitutional restrictions on the impairment of existing obligations be repealed at an election within the City held upon petition of 10% of the City's qualified voters.

### **Collection**

Taxes are due on receipt of the tax bill and become delinquent after January 31 of the following year. However, a person over 65 years of age is entitled by law to pay current taxes on his residence homestead in installments or to defer taxes without penalty during the time he owns and occupies the property as his residence homestead. The date of the delinquency of a tax bill may be postponed if the tax bill is mailed after January 10. Delinquent taxes are subject to a 6% penalty for the first month of delinquency, 1% for each month thereafter to June 30 and 12% total if any taxes are unpaid on July 1. Delinquent taxes also accrue interest at the rate of 1% per month during the period they remain outstanding. In addition, if the City engages an attorney for collection of delinquent taxes, the City Council may impose a further penalty not to exceed 20% on all taxes, penalty and interest unpaid on July 1.

Taxes levied by the City are a personal obligation of the person who owns or acquires the property on January 1 of the year for which the tax is imposed. The City has a statutory lien for unpaid taxes on real property against which the taxes are assessed. In the event a taxpayer fails to make timely payment of taxes due the City, the City may file suit to foreclose its lien securing payment of the tax, to enforce personal liability for the tax, or both. The City's tax lien is on a parity with the tax liens of the other state and local jurisdictions levying taxes on property within the City. Whether a lien of the United States is on a parity with or takes priority over a tax lien of the City is determined by applicable federal law. In the absence of such federal law, the City's tax lien takes priority over a lien of the United States. Collection of delinquent taxes may be adversely affected by the amount of taxes owed to other federal, state and local taxing jurisdictions, by effects of the foreclosure sale price attributable to market conditions, by taxpayer redemption rights, or by bankruptcy proceedings which restrain the collection of a taxpayer's debts.

**Historical Analysis of Tax Collection**

<u>Tax Year</u>	<u>Assessed Valuation</u>	<u>Total Tax Rate (b)</u>	<u>Adjusted Tax Levy</u>	<u>Percent Current</u>	<u>Percent Total</u>	<u>Year End Sept 30</u>
1999 (a)	\$14,784,309	\$0.3000	\$44,353	86.24%	86.24%	2000
2000	17,602,499	0.3000	52,835	92.15%	97.01%	2001
2001	18,891,194	0.3000	56,607	89.79%	94.74%	2002
2002	19,455,288	0.3000	62,874	86.78%	107.88%	2003
2003	21,559,208	0.3000	65,670	92.49%	106.43%	2004
2004	21,894,273	0.3000	65,547	93.15%	101.60%	2005
2005	28,326,740	0.3000	84,514	94.10%	97.57%	2006
2006	28,801,793	0.3000	87,484	95.70%	100.41%	2007
2007	32,344,162	0.2955	96,196	95.82%	98.57%	2008
2008	37,220,931	0.2984	109,609	94.91%	97.50%	2009
2009	41,421,760	0.2978	124,884	95.83%	98.38%	2010
2010	42,366,240	0.2968	126,345	95.25%	99.07%	2011
2011	47,961,004	0.2797	134,193		92.46%	2012 (c)

(a) First year taxes have been levied by the City.

(b) Taxes levied for maintenance only; no debt service tax has ever been levied.

(c) Collections through May 31, 2012 only.

**Analysis of Tax Base**

	<u>2011 Ass'd Valuation</u>	<u>Percent</u>	<u>2010 Ass'd Valuation</u>	<u>Percent</u>
Land	\$12,350,640	16.33%	\$12,562,150	18.34%
Improvements	51,288,529	67.81%	44,432,379	65.15%
Personal Property	<u>11,996,611</u>	15.86%	<u>11,210,579</u>	16.44%
Subtotal	\$75,635,780		\$68,205,108	
Less: Exemptions				
Totally Exempt	\$24,131,636		\$22,985,736	
Agriculture Deferred	536,500		526,650	
Over 65/Disabled	2,362,180		2,208,780	
Other	<u>865,126</u>		<u>300,541</u>	
Total Exemptions	<u>\$27,895,442</u>		<u>\$26,021,707</u>	
Taxable Assessed Value (a)	<u>\$47,740,338</u>		<u>\$42,183,401</u>	

(a) Based on original certified valuations only.

**Principal Taxpayers**

<u><i>Taxpayer</i></u>	<u><i>Type of Property</i></u>	<u><i>2011 Ass'd Valuation</i></u>	<u><i>% of 2011 A/V</i></u>	<u><i>2010 Ass'd Valuation</i></u>	<u><i>% of 2010 A/V</i></u>
CLW Inc	Lumber Yard	\$2,245,140	4.68%	\$2,108,140	4.98%
David L Turner	Commercial Property	1,720,440	3.59%	\$1,206,920	2.85%
Allied Power Mar	Hardware Store	899,874	1.88%	881,474	2.08%
Entergy Texas Inc	Utility Company	690,090	1.44%	604,780	1.43%
Vanguard Modular Bldg	Modular Buildings	656,686	1.37%	(a)	
Roan Enterprises I LP	Commercial Property	598,740	1.25%	488,030	1.15%
Archie's Food Basket	Food Market	516,697	1.08%	498,741	1.18%
ZK Management LP	Retail	488,500	1.02%	467,290	1.10%
Archie & Jane Barrillaux	Commercial Property	483,400	1.01%	477,740	1.13%
Grace Myers	Residential/Comm'l	469,860	0.98%	729,910	1.72%
Scott G Davis	Commercial Property	(a)		444,540	1.05%
Total Top Ten		<u>\$8,769,427</u>	<u>18.28%</u>	<u>\$7,907,565</u>	<u>18.66%</u>

(a) Not among top ten for this year.

**Estimated Overlapping Taxes**

Under Texas law, if ad valorem taxes levied by a taxing authority become delinquent, a lien is created upon the property which has been taxed, which lien is on a parity with any tax lien on such property in favor of the City. In addition to ad valorem taxes required to retire the aforementioned direct and estimated overlapping debt, certain taxing jurisdictions including those mentioned above are also authorized by Texas law to assess, levy, and collect ad valorem taxes for operation, maintenance, administrative and/or general revenue purposes.

<u><i>Taxing Entities</i></u>	<u><i>2011 Tax Rates</i></u>
Lone Star College District	\$0.1210
Montgomery County	0.4838
Montgomery Co. Emergency Services District No. 11	0.1000
Montgomery County Hospital District	0.0745
Splendora Independent School District	<u>1.3330</u>
Overlapping Taxes	\$2.1093
The City	<u>0.2797</u>
Total Direct & Overlapping Taxes	<u>\$2.3890</u>

**Sales Tax**

The City has adopted the provisions of Article 1066c, Vernon's Texas Civil Statutes, as amended, which grants the City the power to impose and levy a 1% sales tax. The City may not pledge the proceeds from the Sales Tax as security for the Bonds.

The State Comptroller, after deduction of a 2% service fee, currently remits the City's portion of sales tax collections monthly. By statute the Comptroller is required to remit at least twice annually. The following is an analysis of the collection history of the City's sales tax:

<u><i>Ad Valorem Taxation Comparisons</i></u>				
<u><i>Fiscal Year</i></u> <u><i>Ended 9/30</i></u>	<u><i>Sales Tax</i></u> <u><i>Receipts</i></u>	<u><i>Equivalent</i></u> <u><i>Tax Year</i></u>	<u><i>Tax Rate</i></u> <u><i>Equivalent</i></u>	<u><i>% of Adjusted</i></u> <u><i>Tax Levy</i></u>
2007	\$169,550	2006	\$0.5887	193.81%
2008	190,317	2007	.5884	197.85%
2009	212,347	2008	.5705	193.73%
2010	186,488	2009	.4502	149.33%
2011	212,579	2010	.5018	168.25%

## **RISK FACTORS**

### **General**

Note that Article XI, Section 4 of the Texas Constitution, provides for an overall limitation for General Law Cities of \$1.50 per \$100 assessed valuation. The City has levied a tax rate of \$0.2797 per \$100 assessed valuation for 2011. Should no net revenues be available for debt service on the Bonds, the City would have to substantially increase its tax rate to be able to raise sufficient funds to fully cover debt service.

The City does not anticipate the necessity of collecting ad valorem taxes for payment of the Bonds and expects that debt service on the Bonds will be paid exclusively from net revenues of the System. See "THE UTILITY SYSTEM--Debt Self-Supporting."

### **Overlapping Tax Rates**

Consideration should be given to the total tax burden of all overlapping jurisdictions imposed upon property located within the City as contrasted with property located in comparable real estate developments to gauge the relative tax burden on property within the City. The combination of the City's and the overlapping taxing entities is high as compared to the combined tax rates generally levied upon comparable developments in the market area. Consequently, an increase in the City's tax rate above those anticipated above may have an adverse impact on future development or the construction of taxable improvements in the City. See "City DEBT--Estimated Overlapping Debt" and "TAX DATA--Estimated Overlapping Taxes."

### **Conversion to Surface Water**

The City is located within the boundaries of the Lone Star Groundwater Conservation District (the "Conservation District"), a county-wide regulatory agency that was created by the Texas legislature. The Conservation District was created to provide a regional entity to acquire surface water and build the necessary facilities to convert from ground water to surface water in order to meet the future needs of Montgomery County. The Conservation District has adopted a regulatory plan which requires ground water users within Montgomery County to reduce ground water usage by 30% by January 1, 2015. In order to meet the requirements of the Conservation District the City will be required to convert to surface water sources by January 1, 2015. The Conservation District is currently billing the City \$0.07 per 1,000 gallons of water pumped by the City from its wells. This amount is subject to future increases.

## **Tax Collection Limitations**

The City's ability to cover budgeted expenditures of the general fund may be adversely affected by its inability to collect ad valorem taxes. Under Texas law, the levy of ad valorem taxes by the City constitutes a lien in favor of the City on a parity with the liens of all other state and local taxing authorities on the property against which taxes are levied, and such lien may be enforced by foreclosure. The City's ability to collect ad valorem taxes through such foreclosure may be impaired by (a) collection procedures, (b) a bankruptcy court's stay of tax collection procedure against a taxpayer, or (c) market conditions limiting the proceeds from a foreclosure sale of taxable property. While the City has a lien on taxable property within the City for taxes levied against such property, such lien can be foreclosed only in a judicial proceeding. Because ownership of the land within the City may become highly fragmented among a number of taxpayers, attorney's fees and other costs of collecting any such taxpayer's delinquencies could substantially reduce the net proceeds to the City from a tax foreclosure sale. Finally, any bankruptcy court with jurisdiction over bankruptcy proceedings initiated by or against a taxpayer within the City pursuant to the Federal Bankruptcy Code could stay any attempt by the City to collect delinquent ad valorem taxes against such taxpayer.

## **Registered Owners' Remedies**

If the City defaults in the payment of principal, interest or redemption price on the Bonds when due, or if it fails to make payments into any fund or funds created in the Bond Ordinance, or defaults in the observation or performance of any other covenants, conditions or obligations set forth in the Bond Ordinance the registered owners may seek a writ of mandamus to compel City officials to carry out their legally imposed duties with respect to the Bonds if there is no other available remedy at law to compel performance of the covenants contained in the Bonds or in the Bond Ordinance and the City's obligations are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles and rests with the discretion of the court, but may not be arbitrarily refused. There is no acceleration of maturity of the Bonds in the event of default and, consequently, the remedy of mandamus may have to be relied upon from year to year. The Bond Ordinance does not provide for the appointment of a trustee to represent the interest of the Bondholders upon any failure of the City to perform in accordance with the terms of the Bond Ordinance, or upon any other condition and accordingly all legal actions to enforce such remedies would have to be undertaken at the initiative of, and be financed by, the registered owners. The Texas Supreme Court has ruled in *Tooke v. City of Mexia*, 197 S.W. 3rd 325 (Tex. 2006), that a waiver of sovereign immunity in a contractual dispute must be provided for by statute in "clear and unambiguous" language. Because it is unclear whether the Texas legislature has effectively waived the City's sovereign immunity from a suit for money damages, Bondholders may not be able to bring such a suit against the City for breach of the Bonds or Bond Ordinance covenants in the absence of City action. Even if a judgment against the City could be obtained, it could not be enforced by direct levy and execution against the City's property. Further, the registered owners cannot themselves foreclose on property within the City or sell property within the City to enforce the tax lien on taxable property to pay the principal of and interest on the Bonds.

## **Bankruptcy Limitation to Registered Owners' Rights**

The enforceability of the rights and remedies of registered owners may be limited by laws relating to bankruptcy, reorganization or other similar laws of general application affecting the rights of creditors of political subdivisions such as the City. Subject to the requirements of Texas law discussed below, a political subdivision such as the City may voluntarily file a petition for relief from creditors under Chapter 9 of the Federal Bankruptcy Code, 11 USC sections 901-946. The filing of such petition would automatically stay the enforcement of registered owner's remedies, including mandamus and the foreclosure of tax liens upon property within the City discussed above. The automatic stay would remain in effect until the federal bankruptcy judge hearing the case dismisses the petition, enters an order granting relief from the stay or otherwise allows creditors to proceed against the petitioning political subdivisions.

If a petitioning city were allowed to proceed voluntarily under Chapter 9 of the Federal Bankruptcy Code, it could file a plan for an adjustment of its debts. If such a plan were confirmed by the bankruptcy court, it could, among other things, affect a registered owner by reducing or eliminating the amount of indebtedness, deferring or rearranging the debt service schedule, reducing or eliminating the interest rate, modifying or abrogating collateral or security arrangements,

substituting (in whole or in part) other securities, and otherwise compromising and modifying the rights and remedies of the registered owner's claim against a city.

### **Environmental Regulation and Air Quality**

Wastewater treatment and water supply facilities are subject to stringent and complex environmental laws and regulations. Facilities must comply with environmental laws at the federal, state, and local levels. These laws and regulations can restrict or prohibit certain activities that affect the environment in many ways such as:

- Requiring permits for construction and operation of water supply wells and wastewater treatment facilities;
- Restricting the manner in which wastes are released into the air, water, or soils;
- Restricting or regulating the use of wetlands or other property;
- Requiring action to prevent or mitigate pollution; and
- Imposing substantial liabilities for pollution resulting from facility operations.

Compliance with environmental laws and regulations can increase the cost of planning, designing, constructing and operating water production and wastewater treatment facilities. Sanctions against a city for failure to comply with environmental laws and regulations may include a variety of civil and criminal enforcement measures, including assessment of monetary penalties, imposition of remedial requirements, and injunctive relief as to future compliance of and the ability to operate the City's water supply, wastewater treatment, and drainage facilities. Environmental laws and regulations can also impact an area's ability to grow and develop. The following is a discussion of certain environmental concerns that relate to cities, including the City. It should be noted that changes in environmental laws and regulations occur frequently, and any changes that result in more stringent and costly requirements could materially impact the City.

***Air Quality Issues.*** Air quality control measures required by the United States Environmental Protection Agency (the "EPA") and the TCEQ may impact new industrial, commercial and residential development in Houston and adjacent areas. Under the Clean Air Act ("CAA") Amendments of 1990, the eight-county Houston-Galveston area ("HGB area") – Harris, Galveston, Brazoria, Chambers, Fort Bend, Waller, Montgomery and Liberty counties – was designated by the EPA in 2008 as a severe ozone nonattainment area, with an attainment date of June 15, 2019. Such areas are required to demonstrate progress in reducing ozone concentrations each year until the EPA's "8-hour" ozone standards are met. To provide for reductions in ozone concentrations, the EPA and the TCEQ have imposed increasingly stringent limits on sources of air emissions and require any new source of significant air emissions to provide for a net reduction of air emissions. If the HGB area fails to demonstrate progress in reducing ozone concentrations or fails to meet EPA's standards, EPA may impose a moratorium on the awarding of federal highway construction grants and other federal grants for certain public works construction projects, as well as severe emissions offset requirements on new major sources of air emissions for which construction has not already commenced.

In order to comply with the EPA's standards for the HGB area, the TCEQ has established a state implementation plan ("SIP") setting emission control requirements, some of which regulate the inspection and use of automobiles. These types of measures could impact how people travel, what distances people are willing to travel, where people choose to live and work, and what jobs are available in the HGB area. It is possible that additional controls will be necessary to allow the HGB area to reach attainment by June 15, 2019. These additional controls could have a negative impact on the HGB area's economic growth and development.

***Water Supply & Discharge Issues.*** Water supply and discharge regulations that cities, including the City, may be required to comply with involve: (1) public water supply systems, (2) waste water discharges from treatment facilities, (3) stormwater discharges and (4) wetlands dredge and fill activities. Each of these is addressed below:

Pursuant to the Safe Drinking Water Act ("SDWA"), potable (drinking) water provided by a district to more than twenty-five (25) people or fifteen (15) service connections will be subject to extensive federal and state regulation as a public water supply system, which include, among other requirements, frequent sampling and analyses. Additional or more

stringent regulations or requirements pertaining to these and other drinking water contaminants in the future could require installation of more costly treatment facilities.

Operations of cities are also potentially subject to stormwater discharge permitting requirements under the Clean Water Act and EPA and TCEQ regulations. The TCEQ issued a general permit for stormwater discharges associated with industrial activities and a general permit for stormwater discharges associated with small municipal separate storm sewer systems (which was issued on August 13, 2007 and expires August 12, 2012; TCEQ is currently revising and renewing that permit). The TCEQ and/or EPA are expected to issue a much more stringent stormwater discharge permit in the near future. The City could incur substantial costs to develop and implement such plans as well as to install or implement best management practices to minimize or eliminate unauthorized pollutants that may otherwise be found in stormwater runoff.

Operations of cities, including the City, are also potentially subject to requirements and restrictions under the Clean Water Act regarding the use and alteration of wetland areas that are within the “waters of the United States.” The City must obtain a permit from the U.S. Army Corps of Engineers if operations of the City require that wetlands be filled, dredged, or otherwise altered.

### **Proposed American Jobs Act of 2011**

On September 12, 2011, President Obama submitted to Congress the “American Jobs Act of 2011” (the “American Jobs Act”), which, if enacted, could result in additional federal income tax being imposed on certain owners of tax-exempt obligations, including the Bonds, for tax years beginning on or after January 1, 2013. As proposed, the American Jobs Act would limit for certain individual taxpayers the value of certain deductions and exclusions, including the exclusion for tax-exempt interest, to 28 percent irrespective of the actual marginal tax rate imposed on such taxpayers. The American Jobs Act or other proposed legislation, if enacted, could directly or indirectly reduce or eliminate the benefit of the exclusion of interest on the Bonds from gross income for federal income tax purposes or the exemption of interest on the Bonds. The introduction or enactment of the American Jobs Act or other proposed legislation could also affect the value and liquidity of the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors with respect to the American Jobs Act or other pending or proposed tax legislation.

### **Future Debt**

The City is in process of publishing its intention to sell up to \$1.5 million in certificates of obligation to extend certain utility lines to areas not yet provided with such service. The City will propose a utility service rate increase sufficient to pay debt service on such proposed certificates of obligation.

### **Continuing Compliance with Certain Covenants**

The Bond Ordinance contains covenants by the City intended to preserve the exclusion from gross income of interest on the Bonds. Failure by the City to comply with such covenants on a continuous basis prior to maturity of the Bonds could result in interest on the Bonds becoming taxable retroactively to the date of original issuance.

## **LEGAL MATTERS**

### **Legal Opinions**

Issuance of the Bonds is subject to the approving legal opinion of the Attorney General of Texas to the effect that the Bonds are valid and binding obligations of the City secured by the proceeds of an ad valorem tax levied, within the limits prescribed by law, upon all taxable property in the City and, based upon examination of the transcript of the proceedings incident to authorization and issuance of the Bonds, the legal opinion of Bond Counsel to the effect that (1) the Bonds are valid and legally binding obligations of the City payable from the sources and enforceable in accordance with the terms and conditions described therein, except to the extent that the enforceability thereof may be affected by bankruptcy,

insolvency, reorganization, moratorium, or other similar laws affecting creditors' rights or the exercise of judicial discretion in accordance with general principles of equity, and (2) are payable from annual ad valorem taxes, which are not limited by applicable law in rate or amount, levied against all property within the City which is not exempt from taxation by or under applicable law. 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 Official Statement.

### **Legal Review**

Bond Counsel has reviewed the information appearing in this Official Statement under the sections captioned: "THE BONDS" (except the subsection "--Book-Entry-Only System"), "THE CITY--Authority," "TAX PROCEDURES--Authority," "LEGAL MATTERS - Legal Opinions," "LEGAL MATTERS--Legal Review," "TAX MATTERS," and "CONTINUING DISCLOSURE OF INFORMATION" (except the subsection "--Compliance with Prior Undertakings") solely to determine whether such information fairly summarizes matters of law with respect to the provisions of the documents referred to therein. Special Tax Counsel has reviewed the information in this Official Statement under the section captioned "TAX MATTERS" solely to determine whether such information fairly summarizes matters of law referred to therein. Bond Counsel has not, however, independently verified any of the factual information contained in this Official Statement, nor has it conducted an investigation of the affairs of the City for the purpose of passing upon the accuracy or completeness of this 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 of the information contained herein, other than the matters discussed immediately above.

The legal fees paid to Bond Counsel for services rendered in connection with the issuance of the Bonds are based upon a percentage of the Bonds actually issued, sold and delivered and, therefore, such fees are contingent upon the sale and delivery of the Bonds.

### **No-Litigation Certificate**

On the date of delivery of the Bonds to the Underwriter, the City will execute and deliver to the Underwriter a certificate to the effect that no litigation of any nature has been filed or is pending, as of that date, of which the City has notice, to restrain or enjoin the issuance or delivery of the Bonds, or which would affect the provisions made for their payment or security, or in any manner question the validity of the Bonds.

### **No Material Adverse Change**

The obligations of the Underwriter to take and pay for the Bonds, and of the City to deliver the Bonds, are subject to the condition that, up to the time of delivery of and receipt of payment for the Bonds, there shall have been no material adverse change in the condition (financial or otherwise) of the City subsequent to the date of sale from that set forth or contemplated in the Preliminary Official Statement, as it may have been supplemented or amended through the date of sale.

## **TAX MATTERS**

### **Tax Exemption**

The delivery of the Bonds is subject to an opinion of Andrews Kurth LLP, Special Tax Counsel, to the effect that, assuming continuing compliance by the City with the provisions of the Bond Ordinance subsequent to the issuance of the Bonds, pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions thereunder (1) interest on the Bonds will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, and (2) interest on the Bonds will not be subject to the alternative minimum tax imposed on individuals, except as described below, corporations. The statutes, regulations, rulings, and court decisions on which such opinion is based are subject to change, prospectively or on a retroactive basis.

Interest on the Bonds owned by a corporation other than an “S” corporation or a qualified mutual fund, a real estate investment trust (REIT), financial asset securitization investment trust (FASIT), or real estate mortgage investment conduit (REMIC), will be included in such corporation’s adjusted current earnings for purposes of calculating such corporation’s alternative minimum taxable income. A corporation’s alternative minimum taxable income is the basis on which the alternative minimum tax imposed by Section 55 of the Code will be computed.

In rendering such opinion, Special Tax Counsel will rely upon representations of the City made in a certificate pertaining to the use, expenditure, and investment of the proceeds of the Bonds and certain other funds and, as described above, will assume continuing compliance with certain provisions of the Bond Ordinance. Failure to comply with any of these covenants would cause interest on the Bonds to be includable in the gross income of the owners thereof for federal income tax purposes from the date of the issuance of the Bonds.

Special Tax Counsel will not express any opinion with respect to any other federal, state or local tax consequence under present law or proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, individual recipients of Social Security or Railroad Retirement benefits, “S” corporations with “subchapter C” earnings and profits, owners of an interest in a FASIT, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry (or who have paid or incurred certain expenses allocable to) tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Special Tax Counsel’s opinion is not a guarantee of a result, but represents its legal judgement based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the City described above. No ruling has been sought from the Internal Revenue Service (the “Service”) with respect to the matters addressed in the opinion of Special Tax Counsel, and Special Tax Counsel’s opinion is not binding on the Service. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Bonds is commenced, under current procedures the Service is likely to treat the City as the “taxpayer,” and the owners of the Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Bonds, the City may have different or conflicting interests from the owners of the Bonds. 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 its ultimate outcome.

### **Impact of Proposal in President’s 2013 Budget**

On February 13, 2012, President Obama released the language of his proposed budget for fiscal year 2013 (the “Budget”). One provision of the Budget would have the effect of imposing an additional amount of tax on certain “high income” taxpayers based on, among other things, the amount of interest on tax-exempt obligations, such as the Bonds, received by such taxpayers. As originally proposed, this provision will be effective for taxable years beginning on or after January 1, 2013, and will apply to interest on the Bonds and other tax-exempt obligations received by such taxpayers on or after that date. The introduction or enactment of this provision or any similar legislative proposal may also affect the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds are advised to consult their tax advisors with respect to the impact of the Budget or other legislative proposals, as to which Special Tax Counsel expresses no opinion.

### **Tax Accounting Treatment of Discount and Premium on Certain Bonds**

The initial public offering of certain of the Bonds (the “Discount Bonds”) is less than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount, allocable to the holding period of such Discount Bond by the initial purchaser, will, upon the

disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from gross income, rather than as taxable gain, for federal income tax purposes on the same terms and conditions as those for other interest on the Bonds described above under "TAX EXEMPTION." Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest at the yield to maturity on such Discount Bond, and generally will be allocated to an original purchaser in a different amount from the amount of the payment denominated as interest actually received by the original purchaser during the tax year.

However, such interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by Section 55 of the Code and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, "S" corporations with "subchapter C" earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Moreover, in the event of the redemption, sale or other taxable disposition of a Discount Bond by the initial owner prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

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

The initial public offering of certain of the Bonds (the "Premium Bonds") is greater than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bond. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser may be reduced each year by the amortizable bond premium. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon the sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity. Purchasers of Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium with respect to the Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning Premium Bonds.

### **Qualified Tax-Exempt Obligations for Financial Institutions**

Section 265 of the Code provides, in general, that interest expense incurred to acquire or carry tax-exempt obligations is not deductible from the gross income of the owner thereof. In addition, interest expense incurred by certain owners that are "financial institutions" within the meaning of such section and which is allocable to tax-exempt obligations acquired after August 7, 1986, is completely disallowed as a deduction for taxable years beginning after December 31, 1986. Section 265(b) of the Code provides an exception to this rule for interest expense incurred by financial institutions and allocable to tax-exempt obligations (other than private activity bonds) which are designated by an issuer, such as the City, as "qualified tax-exempt obligations." An issue may be designated as "qualified tax-exempt obligations" only where the amount of such issue, when added to all other tax-exempt obligations (other than private activity bonds) issued or reasonably anticipated to be issued by the issuer during the same calendar year, does not exceed \$10,000,000.

The City has, pursuant to the Bond Ordinance, designated the Bonds as "qualified tax-exempt obligations" and certified its expectation that the above-described \$10,000,000 ceiling will not be exceeded. Accordingly, it is anticipated that

financial institutions that purchase the Bonds will not be subject to the 100 percent (100%) disallowance of interest expense allocable to interest on the Bonds under Section 265(b) of the Code. However, 20 percent (20%) of the interest expense incurred by a financial institution which is allocable to the interest on the Bonds would not be deductible pursuant to Section 291 of the Code.

## **CONTINUING DISCLOSURE OF INFORMATION**

The City, in the Bond Ordinance, has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The City is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the City will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to certain information vendors. This information will be available free of charge from the Municipal Securities Rule Making Board (“MSRB”) via the Electronic Municipal Market Access (“EMMA”) system at [www.emma.msrb.org](http://www.emma.msrb.org).

### **Annual Reports**

The City will provide certain updated financial information and operating data to certain information vendors annually. The information to be updated includes all quantitative financial information and operating data with respect to the City of the general type included in this Official Statement under the heading “APPENDIX A—Financial Statements of the City.”

The financial information and operating data which will be provided within six months after the end of each of its fiscal years. Any information so provided shall be prepared in accordance with generally accepted auditing standards or other such principles as the City may be required to employ from time to time pursuant to state law or regulation, and audited if the audit report is completed within the period during which it must be provided. If the audit report is not complete within such period, then the City shall provide unaudited financial statements for the applicable fiscal year to the MSRB within such six month period, and audited financial statements when the audit report becomes available.

The City’s current fiscal year end is September 30. Accordingly, it must provide updated information by March 31 in each year, unless the City changes its fiscal year. If the City changes its fiscal year, it will notify the MSRB of the change.

### **Material Event Notices**

The City shall notify the MSRB, in a timely manner not in excess of ten business days after the occurrence of the event, of any of the following events with respect to the Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (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 status of the Bonds, or other material events affecting the tax status of the Bonds; (7) modifications to rights of holders 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 City; (13) the consummation of a merger, consolidation, or acquisition involving the City or the System or the sale of all or substantially all of the assets of the City, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a 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 trustee, if material.

### **Availability of Information From EMMA**

Investors will be able to access continuing disclosure information filed with the MSRB at [www.emma.msrb.org](http://www.emma.msrb.org). The City has agreed in the Bond Ordinance to provide the foregoing information only to the MSRB through EMMA. The

information will be available to holders of Bonds only if the holders comply with the procedures of the MSRB or obtain the information through securities brokers who do so.

### **Limitations and Amendments**

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

The City may amend its continuing disclosure agreement from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status or type of operations of the City, if but only if (1) the agreement, as amended, would have permitted an underwriter to purchase or sell Bonds in the offering made hereby in compliance with SEC Rule 15c2-12 (the "Rule"), taking into account any amendments or interpretations of the Rule to the date of such amendment, as well as any changed circumstances, and (2) either (a) the holders of a majority in aggregate principal amount of the outstanding Bonds consent to the amendment or (b) any qualified professional unaffiliated with the City (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the holders and beneficial owners of the Bonds. If the City so amends the agreement, it has agreed to include with any financial information or operating data next provided in accordance with its agreement described 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 financial information and operating so provided. The City may also amend or repeal the agreement if the SEC amends or repeals the applicable provisions of the Rule or a court of final jurisdiction enters judgement that such provisions of the Rule are invalid, and the City 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 provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds in the primary offering of the Bonds.

### **Compliance with Prior Undertakings**

The City failed to timely file its audited financial statements for the fiscal years ended September 30, 2008 through and including 2011. Such financial statements and the material events notice of non-compliance have subsequently been filed with EMMA and the City has implemented procedures to ensure timely filing of all future submissions.

## **GENERAL CONSIDERATIONS**

### **Sources and Compilation of Information**

The information contained in this Official Statement has been obtained primarily from the City and from other sources believed to be reliable. No representation is made as to the accuracy or completeness of the information derived from sources other than the City.

The descriptions herein of the Bonds and the Bond Ordinance do not purport to be complete and all such descriptions of references thereto are qualified in their entirety by reference to the complete form of the Bond Ordinance. 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, ordinances or other documents do not purport to be complete statements of same and are made subject to all of the provisions thereof. Reference should be made to such original sources in all respects.

**Certification as to Official Statement**

At the time of payment for and delivery of the Bonds, the City will furnish the Underwriter a certificate, executed by the City Secretary and Mayor, acting in their official capacities, to the effect that to the best of their knowledge and belief: (a) the descriptions and statements of or pertaining to the City contained in this Official Statement, on the date thereof and on the date of delivery were and are true and correct in all material respects; (b) insofar as the City and its affairs, including its financial affairs, are concerned, this Official Statement did not and does not contain an untrue statement of a material fact or omit to state a material fact required to be stated herein or necessary to make the statements herein, in the light of the circumstances under which they were made, not misleading; and (c) insofar as the descriptions and statements, including financial data contained in this Official Statement, of or pertaining to entities other than the City and their activities are concerned, such statements and data have been obtained from sources which the City believes to be reliable and that the City has no reason to believe that they are untrue in any material respect.

This Official Statement was duly authorized and approved by the City Council of the City of Splendora, Texas as of the date specified on the first page hereof.

/s/ Dorothy Welch  
Mayor, City of Splendora

ATTEST:

/s/ Danna Welter  
City Secretary, City of Splendora

**APPENDIX A–Financial Statements**

# **CITY OF SPLENDORA, TEXAS**

**ANNUAL FINANCIAL REPORT**

**FOR THE YEAR ENDED SEPTEMBER 30, 2011**



**CITY OF SPLENDORA, TEXAS**  
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## INTRODUCTORY SECTION

**CITY OF SPLENDORA, TEXAS**  
*PRINCIPAL CITY OFFICIALS*  
*SEPTEMBER 30, 2011*

Dorothy Welch..... Mayor  
M. Leon Ward..... Councilmember, Position 1  
Clyde Goodson ..... Councilmember, Position 2  
Fred Atkins, Jr. .... Councilmember, Position 3  
Dottie Bruner ..... Councilmember, Position 4  
Buck Clendennen..... Councilmember, Position 5  
Danna Welter .....City Secretary

**FINANCIAL SECTION**

# HLSK

*Hereford, Lynch, Sellars & Kirkham*  
Certified Public Accountants • A Professional Corporation

Conroe  
1406 Wilson Rd., Suite 100  
Conroe, Texas 77304  
Tel 936-756-8127  
Metro 936-441-1338  
Fax 936-756-8132

Members of the  
American Institute of Certified Public Accountants  
Texas Society of Certified Public Accountants  
Private Companies Practice Section  
of the AICPA Division for Firms

Cleveland  
111 East Boothe  
Cleveland, Texas 77327  
Tel 281-592-6443  
Fax 281-592-7706

## INDEPENDENT AUDITORS' REPORT

The Honorable Mayor and Members of City Council  
City of Splendor, Texas  
P.O. Box 1087  
Splendor, Texas 77372

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the City of Splendor (City), as of and for the year ended September 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the City, as of September 30, 2011, and the respective changes in financial position, and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2012, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents, 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The introductory section and other supplementary information are presented for purposes of additional analysis and are not a required part of the financial statements. The other supplementary information section 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 information 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. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Respectfully submitted,

*Hereford, Lynch, Sellars & Kirkham, P.C.*

**HEREFORD, LYNCH, SELLARS & KIRKHAM, P.C.**  
**Certified Public Accountants**

**Conroe, Texas**  
**February 20, 2012**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of City of Splendor's annual financial report presents management's discussion and analysis of the City's financial performance during the fiscal year ended September 30, 2011. Please read it in conjunction with the City's financial statements, which follow this section.

### FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the fiscal year by \$3,449,215 (net assets). Net assets reflect \$1,857,883 that is invested in capital assets, net of related debt.
- During the year, the City's revenues of \$2,642,959 exceeded expenditures of \$2,308,412 in the amount of \$334,547.
- The General Fund reported a fund balance this year of \$124,295, which approximated 20% of General Fund expenditures.

### OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

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

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

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, highway and streets, and culture and recreation. The business-type activities of the City includes water, sewer, and gas operations.

The government-wide financial statements include only the City itself (known as the *primary government*). The government-wide financial statements can be found as noted in the table of contents of this report.

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

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains one individual governmental fund. Information is presented in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund which is required to be a major fund.

The City adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found as noted in the table of contents of this report.

**Proprietary funds.** The City maintains one type of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its Water, Sewer, and Gas Fund.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water, Sewer, and Gas Fund which is considered to be a major fund of the City.

The basic proprietary fund financial statements can be found as noted in the table of contents of this report.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found as noted in the table of contents of this report.

**Other information.** In addition to the basic financial statements and accompanying notes, this report also presents *other supplementary information*, which includes a schedule of taxes receivable and insurance coverage. Other supplementary information can be found as noted in the table of contents of this report.

## FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$3,449,215 at the close of the most recent fiscal year.

Table A-1  
CITY OF SPLENDORA, TEXAS NET ASSETS

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Current and Other Assets	\$ 167,281	\$ 189,138	\$ 2,006,385	\$ 1,757,362	\$ 2,173,666	\$ 1,946,500
Capital Assets	396,798	459,023	5,693,778	5,268,760	6,090,576	5,727,783
<b>Total Assets</b>	<b>564,079</b>	<b>648,161</b>	<b>7,700,163</b>	<b>7,026,122</b>	<b>8,264,242</b>	<b>7,674,283</b>
Long-term Liabilities Outstanding	-	10,376	4,457,050	4,205,000	4,457,050	4,215,376
Other Liabilities	24,353	41,322	333,624	302,917	357,977	344,239
<b>Total Liabilities</b>	<b>24,353</b>	<b>51,698</b>	<b>4,790,674</b>	<b>4,507,917</b>	<b>4,815,027</b>	<b>4,559,615</b>
<b>Net Assets:</b>						
Invested in Capital Assets, net of Related Debt	396,798	448,647	1,461,085	1,288,706	1,857,883	1,737,353
Restricted	-	-	857,306	849,937	857,306	849,937
Unrestricted	142,928	147,816	591,098	379,562	734,026	527,378
<b>Total Net Assets</b>	<b>\$ 539,726</b>	<b>\$ 596,463</b>	<b>\$ 2,909,489</b>	<b>\$ 2,518,205</b>	<b>\$ 3,449,215</b>	<b>\$ 3,114,668</b>

The City's total assets of \$8,264,242 are largely comprised of capital assets, net of accumulated depreciation of \$6,090,576, or 74%. GASB Statement No. 34 requires that all capital assets, including infrastructure, be reported in the government-wide statements.

Long-term liabilities of \$4,457,050 comprise the largest portion of the City's total liabilities of \$4,815,027 at 93%. Of total long-term liabilities, \$284,586 is due within one year, with the remainder \$4,172,464 being due over a period of time greater than one year. A more in-depth discussion of long-term debt can be found in the notes to the financial statements.

By far the largest portion of the City's net assets \$1,857,883 (54 percent) reflects its investment in capital assets (e.g., land, water system, sewer system, gas system, buildings and improvements, machinery, equipment, and vehicles, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The \$734,026 of unrestricted net assets represent resources available to fund the programs of the City net year.

**Changes in net assets.** The City's combined increase (decrease) in net assets was \$334,547 at September 30, 2011.

Table A-2  
CITY OF SPLENDORA, TEXAS CHANGE IN NET ASSETS

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
<b>Revenues:</b>						
<b>Program Revenues:</b>						
Charges for Services	\$ 151,221	\$ 145,038	\$ 1,806,096	\$ 1,524,129	\$ 1,957,317	\$ 1,669,167
Operating Grants and Contributions	10,095	10,191	7,730	230,408	17,825	240,599
Capital Grants and Contributions	-	-	240,713	-	240,713	-
<b>General Revenues:</b>						
Property Taxes	129,245	126,527	-	-	129,245	126,527
Sales Taxes	212,579	186,488	-	-	212,579	186,488
Franchise Taxes	62,689	62,232	-	-	62,689	62,232
Earnings on Investments	62	322	2,915	4,334	2,977	4,656
Miscellaneous	19,614	8,652	-	-	19,614	8,652
<b>Total Revenues</b>	<b>585,505</b>	<b>539,450</b>	<b>2,057,454</b>	<b>1,758,871</b>	<b>2,642,959</b>	<b>2,298,321</b>
<b>Expenses:</b>						
General Government	107,377	85,104	-	-	107,377	85,104
Public Safety	542,481	486,806	-	-	542,481	486,806
Highways and Streets	7,792	48,847	-	-	7,792	48,847
Culture and Recreation	13,876	13,944	-	-	13,876	13,944
Interest and Fees on Long-term Debt	716	2,516	-	-	716	2,516
Water, Sewer and Gas	-	-	1,636,170	1,439,927	1,636,170	1,439,927
<b>Total Expenses</b>	<b>672,242</b>	<b>637,217</b>	<b>1,636,170</b>	<b>1,439,927</b>	<b>2,308,412</b>	<b>2,077,144</b>
Excess (Deficiency) Before Transfers	(86,737)	(97,767)	421,284	318,944	334,547	221,177
Transfers In (Out)	30,000	-	(30,000)	-	-	-
Increase (Decrease) in Net Assets	(56,737)	(97,767)	391,284	318,944	334,547	221,177
Net Assets - Beginning	596,463	694,230	2,518,205	2,199,261	3,114,668	2,893,491
Net Assets - Ending	\$ <u>539,726</u>	\$ <u>596,463</u>	\$ <u>2,909,489</u>	\$ <u>2,518,205</u>	\$ <u>3,449,215</u>	\$ <u>3,114,668</u>

### Governmental Activities

The City's total revenues were \$585,505 from all governmental activities. A significant portion, \$151,221 or 26%, of the City's revenue comes from charges for services (primarily fines). Sales tax revenue accounts for \$212,579, or 36%, property tax revenue accounts for \$129,245, or 22% and franchise taxes total \$62,689, or 11%, of total revenue for governmental activities.

The total cost of all governmental programs and services was \$672,242. The public safety function accounted for 542,481, or 81% of this total. Expenses increased \$35,025 in total, which consists primarily of an increase in public safety of \$55,675 and general government of \$22,273 while highways and streets decreased by \$41,055.

The decrease in net assets for governmental activities is primarily due to an increase in expenditures on public safety and general government.

### **Business-type Activities**

Business-type activities are financed in whole or part by fees charged to external users for goods or services (water, sewer, and gas). They are reported in the enterprise fund. Business-type activities increased the City's net assets by \$391,284. Revenue can be reported as program revenue or general revenue—all revenues are general unless they are required to be reported as program revenues. Program revenue, charges for services, which includes revenues attributable to a specific program because they are a result of exchange-like transactions or other events, such as charges to customers. Charges for service of \$1,806,096 are utilized to provide funds for program expenses of \$1,636,170.

The increase in net assets for business-type activities is primarily due to increased water charges collected as a result of a new meter reading system and an increase in federal grants for water and sewer system improvements.

### **FINANCIAL ANALYSIS OF THE CITY'S FUNDS**

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

**Governmental funds.** The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unassigned fund balance* may serve as a useful measure of a City's net resources available for spending at the end of the fiscal year.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, the unassigned fund balance of the general fund and the total fund balance were both \$124,295. As a measure of the general fund's liquidity, it may be useful to compare both unassigned fund balance and total fund balance to total fund expenditures. Unassigned fund balance and total fund balance both represents 16% and 20%, respectively, of the City's total general fund expenditures.

The fund balance of the City's general fund decreased by \$6,432 due to the increase in public safety expenditures exceeded the decrease in highway and streets expenditures.

**Proprietary fund.** The City's proprietary fund financial statements reflect the City's water, sewer, and gas activities in a Water, Sewer, and Gas fund. The net increase in net assets during the current year in the Water, Sewer, and Gas fund was \$391,284. The increase in net assets is due to increased water charges collected as a result of a new meter reading system and an increase in federal grants for water and sewer system improvements exceed the increase in operational expenses.

### **General Fund Budgetary Highlights**

The City amended the budget several times throughout the year. Significant differences between the original budget and the final amended budget of the general fund can be briefly summarized as follows:

- \$25,540 increase in General Government

Significant differences between the final budget and actual amounts can be briefly summarized as follows:

- Actual Expenditures, when compared to the final budgeted amount, had a \$32,107 favorable variance due to appropriations planned for general government and public safety were not initiated.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets

At the end of 2011, the City had invested \$6,090,576 in a broad range of capital assets.

The major capital asset events during the current fiscal year were as follows:

- \$505,500 Water meter reading system
- \$136,969 Generators for pump stations

Table A-3  
CITY OF SPLENDORA, TEXAS CAPITAL ASSETS  
(net of depreciation)

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Land	\$ 37,260	\$ 37,260	\$ -	\$ -	\$ 37,260	\$ 37,260
Water System	-	-	3,424,644	2,754,042	3,424,644	2,754,042
Sewer System	-	-	4,827,068	4,827,068	4,827,068	4,827,068
Gas System	-	-	1,070,253	1,070,253	1,070,253	1,070,253
Buildings and Improvements	453,158	453,158	8,150	8,150	461,308	461,308
Machinery, Equipment and Vehicles	338,602	338,602	263,249	258,099	601,851	596,701
Infrastructure	108,743	108,743	-	-	108,743	108,743
Construction in Progress	-	-	6,548	-	6,548	-
<b>Totals</b>	<b>937,763</b>	<b>937,763</b>	<b>9,599,912</b>	<b>8,917,612</b>	<b>10,537,675</b>	<b>9,855,375</b>
Total Accumulated Depreciation	(540,965)	(478,740)	(3,906,134)	(3,648,852)	(4,447,099)	(4,127,592)
<b>Net Capital Assets</b>	<b>\$ 396,798</b>	<b>\$ 459,023</b>	<b>\$ 5,693,778</b>	<b>\$ 5,268,760</b>	<b>\$ 6,090,576</b>	<b>\$ 5,727,783</b>

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

### Long-Term Debt

At year-end, the City had \$4,457,050 in long-term debt outstanding as shown in Table A-4. More detailed information about the City's debt is presented in the notes to the financial statements.

Table A-4  
CITY OF SPLENDORA, TEXAS LONG-TERM DEBT

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Note Payable	\$ -	\$ 10,376	\$ -	\$ -	\$ -	\$ 10,376
Bonds and Certificates of Obligation	-	-	3,995,000	4,205,000	3,995,000	4,205,000
Capital Lease	-	-	462,050	-	462,050	-
<b>Total Long-term Debt</b>	<b>\$ -</b>	<b>\$ 10,376</b>	<b>\$ 4,457,050</b>	<b>\$ 4,205,000</b>	<b>\$ 4,457,050</b>	<b>\$ 4,215,376</b>

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

- Total tax rate .2797 per \$100 valuation in fiscal year 2012 decreased from .2968 for the fiscal year 2011.
- These indicators were taken into account when adopting the general fund budget for 2012. Amounts available for appropriation in the general fund budget are \$97,718 at September 30, 2011. Property taxes are expected to increase due to the increase in values. The City will use these increases in revenues to finance programs they currently offer.
- The City's budgetary general fund balance is expected to remain approximately the same.

## **CONTACTING THE CITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City Secretary.

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## **BASIC FINANCIAL STATEMENTS**

**CITY OF SPLENDORA, TEXAS**

STATEMENT OF NET ASSETS

SEPTEMBER 30, 2011

EXHIBIT A-1

	Governmental Activities	Business-type Activities	Total
<b>ASSETS:</b>			
<i>Cash and Cash Equivalents</i>	\$ 104,836	\$ 553,012	\$ 657,848
<i>Taxes Receivable (Net of Allowances for Uncollectibles)</i>	18,633	-	18,633
<i>Accounts Receivable (Net of Allowance for Uncollectibles)</i>	-	185,674	185,674
<i>Intergovernmental</i>	17,235	136,969	154,204
<i>Restricted Cash</i>			
<i>Cash and Cash Equivalents - Reserve</i>	-	893,832	893,832
<i>Cash and Cash Equivalents - Construction</i>	-	138,151	138,151
<i>Cash and Cash Equivalents - Grants</i>	-	12,541	12,541
<i>Cash - Court Technology</i>	19,954	-	19,954
<i>Cash - Police Department Officers' Education</i>	5,378	-	5,378
<i>Cash - Police Department Forfeitures</i>	1,245	-	1,245
<i>Bond Issuance Costs</i>	-	86,206	86,206
<i>Capital Assets:</i>			
<i>Land</i>	37,260	-	37,260
<i>Water System</i>	-	3,424,644	3,424,644
<i>Sewer System</i>	-	4,827,068	4,827,068
<i>Gas System</i>	-	1,070,253	1,070,253
<i>Buildings and Improvements</i>	453,158	8,150	461,308
<i>Machinery, Equipment, and Vehicles</i>	338,602	263,249	601,851
<i>Infrastructure</i>	108,743	-	108,743
<i>Construction in Progress</i>	-	6,548	6,548
<i>Accumulated Depreciation</i>	(540,965)	(3,906,134)	(4,447,099)
<b>Total Assets</b>	<u>564,079</u>	<u>7,700,163</u>	<u>8,264,242</u>
<b>LIABILITIES:</b>			
<i>Accounts Payable</i>	14,855	164,736	179,591
<i>Accrued Liabilities</i>	9,498	8,427	17,925
<i>Accrued Interest Payable</i>	-	36,526	36,526
<i>Customer Deposits</i>	-	123,935	123,935
<i>Noncurrent Liabilities:</i>			
<i>Due within one year</i>	-	284,586	284,586
<i>Due in more than one year</i>	-	4,172,464	4,172,464
<b>Total Liabilities</b>	<u>24,353</u>	<u>4,790,674</u>	<u>4,815,027</u>
<b>NET ASSETS:</b>			
<i>Invested in Capital Assets, Net of Related Debt</i>	396,798	1,461,085	1,857,883
<i>Restricted for Debt (Expendable)</i>	-	857,306	857,306
<i>Unrestricted</i>	142,928	591,098	734,026
<b>Total Net Assets</b>	<u>\$ 539,726</u>	<u>\$ 2,909,489</u>	<u>\$ 3,449,215</u>

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

**CITY OF SPLENDORA, TEXAS**  
**STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

EXHIBIT A-2

FUNCTIONS/PROGRAMS	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
<b>PRIMARY GOVERNMENT:</b>							
Governmental Activities:							
General Government	\$ 107,377	\$ 8,955	\$ -	\$ -	\$ (98,422)	\$ -	\$ (98,422)
Public Safety	542,481	142,266	10,095	-	(390,120)	-	(390,120)
Highways and Streets	7,792	-	-	-	(7,792)	-	(7,792)
Culture and Recreation	13,876	-	-	-	(13,876)	-	(13,876)
Interest and Fees on Long-term Debt	716	-	-	-	(716)	-	(716)
Total Governmental Activities	<u>672,242</u>	<u>151,221</u>	<u>10,095</u>	<u>-</u>	<u>(510,926)</u>	<u>-</u>	<u>(510,926)</u>
Business-type Activities:							
Water, Sewer and Gas	<u>1,636,170</u>	<u>1,806,096</u>	<u>7,730</u>	<u>240,713</u>	-	418,369	418,369
Total Primary Government	<u>\$ 2,308,412</u>	<u>\$ 1,957,317</u>	<u>\$ 17,825</u>	<u>\$ 240,713</u>	<u>(510,926)</u>	<u>418,369</u>	<u>(92,557)</u>
General Revenues:							
Property Taxes					129,245	-	129,245
Sales Taxes					212,579	-	212,579
Franchise Taxes					62,689	-	62,689
Earnings on Investments					62	2,915	2,977
Miscellaneous					19,614	-	19,614
Transfers					30,000	(30,000)	-
Total General Revenues and Transfers					<u>454,189</u>	<u>(27,085)</u>	<u>427,104</u>
Change in Net Assets					<u>(56,737)</u>	<u>391,284</u>	<u>334,547</u>
Net Assets - Beginning					596,463	2,518,205	3,114,668
Net Assets - Ending					<u>\$ 539,726</u>	<u>\$ 2,909,489</u>	<u>\$ 3,449,215</u>

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

**CITY OF SPLENDORA, TEXAS**  
**BALANCE SHEET - GOVERNMENTAL FUNDS**  
**SEPTEMBER 30, 2011**

EXHIBIT A-3

	<u>General Fund</u>
<b>ASSETS :</b>	
Assets:	
<i>Cash and Cash Equivalents</i>	\$ 104,836
<i>Taxes Receivable (Net of Allowances for Uncollectibles)</i>	18,633
<i>Intergovernmental</i>	17,235
Restricted Cash:	
<i>Cash - Court Technology</i>	19,954
<i>Cash - Police Department Officers' Education</i>	5,378
<i>Cash - Police Department Forfeitures</i>	1,245
<b>Total Assets</b>	<b>\$ <u>167,281</u></b>
<b>LIABILITIES:</b>	
<i>Accounts Payable</i>	\$ 14,855
<i>Accrued Liabilities</i>	9,498
<i>Deferred Revenue</i>	18,633
<b>Total Liabilities</b>	<b><u>42,986</u></b>
<b>FUND BALANCE:</b>	
<i>Restricted for Technology</i>	19,954
<i>Restricted for Police Department Officers' Education</i>	5,378
<i>Restricted for Police Department Forfeitures</i>	1,245
<i>Unassigned</i>	97,718
<b>Total Fund Balance</b>	<b><u>124,295</u></b>
<b>Total Liabilities and Fund Balance</b>	<b>\$ <u>167,281</u></b>

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

**CITY OF SPLENDORA, TEXAS**

EXHIBIT A-4

*RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS  
SEPTEMBER 30, 2011*

**Total Fund Balance - Governmental Funds (Exhibit A-3)** \$ 124,295

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in the governmental fund. The cost of the assets is \$937,763 and the accumulated depreciation is \$540,965. 396,798

Property taxes receivable are not available soon enough to pay for the current period's expenditure's and, therefore, are deferred in the funds. 18,633

**Total Net Assets - Governmental Activities (Exhibit A-1)** \$ 539,726

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

**CITY OF SPLENDORA, TEXAS**

EXHIBIT A-5

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCES - GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	General Fund
<b>REVENUE:</b>	
<i>Taxes:</i>	
<i>Property Taxes</i>	\$ 127,701
<i>Sales and Other Taxes</i>	212,579
<i>Franchise Taxes</i>	62,689
<i>License and Permits</i>	8,955
<i>Earnings on Investments</i>	62
<i>Fines</i>	142,266
<i>Contributions and Donations</i>	10,095
<i>Miscellaneous</i>	19,614
Total Revenues	<u>583,961</u>
<b>EXPENDITURES:</b>	
<i>Current:</i>	
<i>General Government</i>	90,652
<i>Public Safety</i>	504,089
<i>Highway and Streets</i>	1,106
<i>Culture and Recreation</i>	13,454
<i>Debt Service:</i>	
<i>Principal</i>	10,376
<i>Interest and Fiscal Charges</i>	716
<i>Capital Outlay:</i>	
<i>Public Safety</i>	-
<i>Culture and Recreation</i>	-
Total Expenditures	<u>620,393</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(36,432)</u>
<i>Other Financing Sources (Uses):</i>	
<i>Transfer In</i>	30,000
Total Other Financing Sources (Uses)	<u>30,000</u>
Net Change in Fund Balance	(6,432)
Fund Balance - Beginning	130,727
<b>Fund Balance - Ending</b>	<b><u>\$ 124,295</u></b>

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

**CITY OF SPLENDORA, TEXAS**

EXHIBIT A-6

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,  
 AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
 TO THE STATEMENT OF ACTIVITIES  
 FOR THE YEAR ENDED SEPTEMBER 30, 2011

**Net Change in Fund Balance - Governmental Funds (Exhibit A-5)** \$ (6,432)

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are not reported in the governmental funds as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense.

Capital Outlay	-	
Depreciation Expense	<u>(62,225)</u>	(62,225)

Because some property taxes will not be collected for several months after the City's fiscal year ends, they are not considered "available" revenues and are deferred in the governmental funds. Deferred tax revenues increased by this amount this year.

1,544

Repayment of note principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

10,376

**Change in Net Assets of Governmental Activities (Exhibit A-2)** \$ (56,737)

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

**CITY OF SPLENDORA, TEXAS**

EXHIBIT A-7

GENERAL FUND  
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES  
IN FUND BALANCE - BUDGET (GAAP BASIS) AND ACTUAL  
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>REVENUE:</b>				
<i>Taxes:</i>				
<i>Property Taxes</i>	\$ 125,000	\$ 127,000	\$ 127,701	\$ 701
<i>Sales and Other Taxes</i>	214,500	214,500	212,579	(1,921)
<i>Franchise Taxes</i>	51,500	61,500	62,689	1,189
<i>License and Permits</i>	4,650	4,650	8,955	4,305
<i>Earnings on Investments</i>	500	500	62	(438)
<i>Fines</i>	181,550	189,550	142,266	(47,284)
<i>Contributions and Donations</i>	10,300	10,300	10,095	(205)
<i>Miscellaneous</i>	4,500	14,500	19,614	5,114
Total Revenues	<u>592,500</u>	<u>622,500</u>	<u>583,961</u>	<u>(38,539)</u>
<b>EXPENDITURES:</b>				
<i>Current:</i>				
<i>General Government</i>	76,900	102,440	90,652	11,788
<i>Public Safety</i>	526,900	523,768	504,089	19,679
<i>Highways and Streets</i>	5,000	1,500	1,106	394
<i>Culture and Recreation</i>	13,700	13,700	13,454	246
<i>Debt Service:</i>				
<i>Principal</i>	-	10,376	10,376	-
<i>Interest and Fiscal Charges</i>	-	716	716	-
Total Expenditures	<u>622,500</u>	<u>652,500</u>	<u>620,393</u>	<u>32,107</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(30,000)</u>	<u>(30,000)</u>	<u>(36,432)</u>	<u>(6,432)</u>
<i>Other Financing Sources (Uses):</i>				
<i>Transfers In</i>	<u>30,000</u>	<u>30,000</u>	<u>30,000</u>	<u>-</u>
Total Other Financing Sources (Uses)	<u>30,000</u>	<u>30,000</u>	<u>30,000</u>	<u>-</u>
Net Change in Fund Balances	-	-	(6,432)	(6,432)
Fund Balance - Beginning	130,727	130,727	130,727	-
Fund Balance - Ending	<u>\$ 130,727</u>	<u>\$ 130,727</u>	<u>\$ 124,295</u>	<u>\$ (6,432)</u>

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

**CITY OF SPLENDORA, TEXAS**

STATEMENT OF NET ASSETS

PROPRIETARY FUND

SEPTEMBER 30, 2011

EXHIBIT A-8

Enterprise  
Fund  

---

Water,  
Sewer, and Gas  
Fund  

---

**ASSETS:**

Current Assets:

<i>Cash and Cash Equivalents</i>	\$ 553,012
<i>Accounts Receivable (Net of Allowances for Uncollectibles)</i>	185,674
<i>Intergovernmental</i>	136,969
Total Current Assets	<hr/> 875,655 <hr/>

Noncurrent Assets:

Restricted Cash:

<i>Cash and Cash Equivalents - Reserve</i>	893,832
<i>Cash and Cash Equivalents - Construction</i>	138,151
<i>Cash and Cash Equivalents - Grants</i>	12,541

Bond Issuance Costs

86,206

Capital Assets:

<i>Water System</i>	3,424,644
<i>Sewer System</i>	4,827,068
<i>Gas System</i>	1,070,253
<i>Buildings and Improvements</i>	8,150
<i>Machinery, Equipment and Vehicles</i>	263,249
<i>Construction in Progress</i>	6,548
<i>Less Accumulated Depreciation</i>	<hr/> (3,906,134) <hr/>
Total Noncurrent Assets	<hr/> 6,824,508 <hr/>

**Total Assets**

**\$ 7,700,163**

**LIABILITIES:**

Current Liabilities:

<i>Accounts Payable</i>	\$ 164,736
<i>Accrued Liabilities</i>	8,427
<i>Accrued Interest Payable</i>	36,526
<i>Customer Deposits</i>	123,935
Total Current Liabilities	<hr/> 333,624 <hr/>

Noncurrent Liabilities:

<i>Capital Lease - Current</i>	64,586
<i>Bonds and Certificates of Obligation - Current</i>	220,000
<i>Capital Lease - Long Term</i>	397,464
<i>Bonds and Certificates of Obligation - Long Term</i>	3,775,000
Total Noncurrent Liabilities	<hr/> 4,457,050 <hr/>
Total Liabilities	<hr/> 4,790,674 <hr/>

**NET ASSETS:**

<i>Invested in Capital Assets, Net of Related Debt</i>	1,461,085
<i>Restricted for Debt Service (Expendable)</i>	857,306
<i>Unrestricted</i>	591,098
Total Net Assets	<hr/> 2,909,489 <hr/>

**Total Liabilities and Net Assets**

**\$ 7,700,163**

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

**CITY OF SPLENDORA, TEXAS**

EXHIBIT A-9

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES  
IN FUND NET ASSETS - PROPRIETARY FUND  
FOR THE YEAR ENDED SEPTEMBER 30, 2011**

	<u>Enterprise Fund Water, Sewer, and Gas Fund</u>
<b>OPERATING REVENUES:</b>	
Charges for Services:	
<i>Water Sales and Fees</i>	\$ 1,550,355
<i>Sewer Sales and Fees</i>	130,476
<i>Gas Sales and Fees</i>	125,265
Total Operating Revenues	<u>1,806,096</u>
<b>OPERATING EXPENSES:</b>	
<i>Administration</i>	297,345
<i>Water System</i>	638,217
<i>Sewer System</i>	135,240
<i>Gas System</i>	60,833
<i>Depreciation and Amortization</i>	273,104
Total Operating Expenses	<u>1,404,739</u>
Operating Income	<u>401,357</u>
<b>NON-OPERATING REVENUES (EXPENSES):</b>	
<i>Interest Revenue</i>	2,915
<i>Intergovernmental</i>	248,443
<i>Interest Expense</i>	(230,882)
<i>Grant Expense</i>	(549)
Total Non-operating Revenues (Expenses)	<u>19,927</u>
Income before Transfers	421,284
<i>Transfer Out</i>	<u>(30,000)</u>
Change in Net Assets	391,284
Total Net Assets - Beginning	<u>2,518,205</u>
<b>Total Net Assets - Ending</b>	<b><u>\$ 2,909,489</u></b>

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

**CITY OF SPLENDORA, TEXAS**  
**STATEMENT OF CASH FLOWS**  
**PROPRIETARY FUND**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

**EXHIBIT A-10**

	Enterprise Fund <u>Water, Sewer, and Gas Fund</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
<i>Cash Received for Services</i>	\$ 1,781,077
<i>Cash Payments to Suppliers for Goods and Services</i>	(1,099,669)
Net Cash Provided (Used) by Operating Activities	<u>681,408</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
<i>Transfer Out</i>	(30,000)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(30,000)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
<i>Intergovernmental Funds Collected</i>	110,925
<i>Proceeds on Capital Debt</i>	505,500
<i>Purchase of Capital Assets</i>	(682,300)
<i>Principal Paid on Capital Debt</i>	(253,450)
<i>Interest and Fiscal Charges Paid on Capital Debt</i>	(231,341)
Net Cash Provided (Used) for Capital & Related Financing Activities	<u>(550,666)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
<i>Interest and Dividends Received</i>	2,915
Net Cash Provided (Used) for Investing Activities	<u>2,915</u>
Net Increase (Decrease) in Cash and Cash Equivalents	103,657
Cash and Cash Equivalents at Beginning of Year	1,493,879
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ <u><u>1,597,536</u></u></b>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Operating Income (Loss)	\$ 401,357
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:	
<i>Depreciation and Amortization</i>	273,104
Change in Assets and Liabilities:	
<i>Decrease (Increase) in Accounts Receivables, net</i>	(24,219)
<i>Increase (Decrease) in Accounts Payable</i>	35,805
<i>Increase (Decrease) in Accrued Liabilities</i>	(3,839)
<i>Increase (Decrease) in Customer Deposits</i>	(800)
Total Adjustments	<u>280,051</u>
<b>Net Cash Provided (Used) by Operating Activities</b>	<b>\$ <u><u>681,408</u></u></b>

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

**CITY OF SPLENDORA, TEXAS**  
*NOTES TO THE FINANCIAL STATEMENTS*  
*FOR THE YEAR ENDED SEPTEMBER 30, 2011*

**A. Summary of Significant Accounting Policies**

1. Reporting Entity

The accompanying financial statements of City of Splendor, Texas (the "City") have been prepared in conformity with accounting principles applicable to governmental units which are generally accepted in the United States of America. The Governmental Accounting Standards Board ("GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

The City's basic financial statements include the accounts of all its operations. The City evaluated whether any other entity should be included in these financial statements. The criteria for including organizations as component units within the City's reporting entity, as set forth in GASB Statement No. 14, "The Financial Reporting Entity," include whether:

- The organization is legally separate (can sue and be sued in its name)
- The City holds the corporate powers of the organization
- The City appoints a voting majority of the organization's board
- The City is able to impose its will on the organization
- The organization has the potential to impose a financial benefit/burden to the City
- There is fiscal dependency by the organization on the City
- The exclusion of the organization would result in misleading or incomplete financial statements

Based on these criteria, the City has no component units. Additionally, the City is not a component unit of any other reporting entity as defined by the GASB Statement.

2. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., statement of net assets and the statement of activities) report information on all the financial activities of the primary government. These statements distinguish between the governmental and business-type activities of the City. Governmental activities generally are financed through taxes, intergovernmental revenues and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities presents a comparison between direct expenses and program revenues for the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Depreciation expense has been allocated to all applicable functions in order to present the expenditures of the City more accurately on the statement of activities. Program revenues include (a) fees, fines and charges paid by the recipients of goods or services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

The fund financial statements provide information about the City's funds, with separate statements presented for each fund category. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. If the City had any additional governmental and enterprise funds, they would be aggregated and reported as nonmajor funds.

3. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

**Government-wide and Proprietary Fund Financial Statements:** These financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants,

**CITY OF SPLENDORA, TEXAS**  
*NOTES TO THE FINANCIAL STATEMENTS*  
*FOR THE YEAR ENDED SEPTEMBER 30, 2011*

contributions and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

**Governmental Fund Financial Statements:** Governmental funds are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Under this method, revenues are recognized when they are both measurable and available. The City considers revenues reported in the governmental funds to be available if the revenues are collected within 60 days after year-end. Revenues from local sources consist primarily of property taxes. Revenues received from the State and investment earnings are recognized under the susceptible-to-accrual concept. Property tax and miscellaneous revenues are recorded as revenue when received. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of governmental activities long-term debt and acquisitions under long-term debt agreements are reported as other financing sources.

The City reports the following *major governmental fund*:

**General Fund.** This is the City's primary operating fund. It accounts for all financial resources of the City except those required to be accounted for in another fund. The principal sources of revenue of the General Fund are property taxes, sales taxes, franchise taxes and fines.

The City reports the following *major enterprise fund*:

**Water, Sewer, and Gas Fund.** This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the costs (expenses, including depreciation) of providing water, sewer, and gas services to the general public on a continuing basis are financed or recovered primarily through user charges or periodic determination of revenues earned, expenses incurred and/or net income is appropriated for capital maintenance, public policy, management control, accountability or other purposes.

Under GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," all proprietary funds will continue to follow Financial Accounting Standards Board ("FASB") standards issued on or before November 30, 1989. However, from that date forward, proprietary funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements unless they conflict with GASB guidance. The City has chosen not to apply future FASB standards.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) fees, fines, charges to customers or applicants for goods, services, or privileges provided and 2) operating grants and contributions including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes and interest.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Water, Sewer and Gas enterprise fund are charges to customers for sales and services. The Water, Sewer, and Gas Fund also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for the enterprise fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**CITY OF SPLENDORA, TEXAS**  
 NOTES TO THE FINANCIAL STATEMENTS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2011

When both restricted and unrestricted (committed, assigned, or unassigned) resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed. The City considers that committed amounts would be reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any unrestricted fund balance classification could be used.

4. Assets, Liabilities, and Net Asset Amounts

a. Deposits and Investments

The City's cash and cash equivalents are considered to be cash on hand and bank deposits at the local depository, including restricted cash.

The City's funds are required to be deposited and invested under the terms of a depository contract. The depository bank deposits for safekeeping and trust with the City's agent bank approved pledged securities in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

The City is authorized to invest in obligations of the U.S. Treasury or the State of Texas, certain U.S. Agencies, certificates of deposit, money market savings accounts, certain municipal securities, repurchase agreements or investment pools.

Investments for the City are reported at fair value. The City currently invests in certificates of deposit with their local depository.

b. Property Taxes

Property values are determined by the County Central Appraisal District as of July 31 of each year. Prior to October 1 of each year, the City sets its tax rate thus creating the tax levy. The taxes are levied and payable October 1 on property values assessed as of January 1. Taxes may be paid without penalty before February 1 of the following year and create a tax lien as of July 1 of each year. The tax assessor/collector for Montgomery County bills and collects the property taxes for the City. City property tax revenues are recognized when levied to the extent that they result in current receivables. The general fund current tax rate to finance general government service for the year ended September 30, 2011 was \$0.2968 per \$100.

The allowance for uncollectible tax receivables within the General Fund is \$776, which is based upon historical experience in collecting property taxes. Uncollectible personal property taxes are periodically reviewed and written off, but the City is prohibited from writing off real property taxes without specific statutory authority from the Texas Legislature.

Tax revenues of the general fund are reported net of uncollectible amounts. Total uncollectible amounts related to revenues of the current period increased (decreased) revenues as follows:

Uncollectibles Related to General Fund Property Taxes	\$	123
<i>Total Uncollectibles of the Current Fiscal Year</i>	<u>\$</u>	<u>123</u>

c. Water, Sewer, and Gas Accounts Receivable

Water, sewer, and gas receivables are shown net of an allowance for uncollectibles. The allowance is approximately 19% of the outstanding accounts receivable balance at September 30, 2011.

The allowance for uncollectible accounts receivable within the Enterprise Fund is \$43,250 which is based upon water, sewer, and gas charges that are more than sixty days past due. Uncollectible water, sewer, and gas charges are periodically reviewed and written off.

**CITY OF SPLENDORA, TEXAS**  
 NOTES TO THE FINANCIAL STATEMENTS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2011

Operating revenues of the enterprise fund are reported net of uncollectible amounts. Total uncollectible amounts related to revenues of the current period increased (decreased) revenues as follows:

Uncollectibles Related to the Water, Sewer, and Gas Fund	\$ (7,250)
<i>Total Uncollectibles of the Current Fiscal Year</i>	<u>\$ (7,250)</u>

d. Interfund Activity

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balance outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

e. Receivables and Payables

Other receivables (due from other governments and due from other) are recorded when applicable requirements are met during the fiscal year. The City books payables when a good or service is received and the invoice will be paid during a subsequent period.

f. Restricted Assets

Reserve:

Certain proceeds of the Water, Sewer, and Gas Fund revenue bonds, as well as resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants.

Construction:

Certain resources have been set aside to fund capital asset replacements.

Grants:

Certain resources set aside by grant agreements.

Court Technology, Police Department Officers' Education, and Police Department Forfeitures:

Certain fine revenues set aside by law to be expended to enhance the court and police department.

g. Capital Assets

The following capital assets, which include land, buildings and improvements, water system, sewer system, gas system, machinery, equipment, and vehicles, construction in progress, and infrastructure assets (e.g., roads, bridges, sidewalks, similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets, other than land and land improvements, are defined by the government as assets with an initial, individual cost of more than \$5,000 (amount not rounded) and an estimated useful life in excess of two years.

**CITY OF SPLENDORA, TEXAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

The following capital assets are being depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives</u>
Water System	10-40
Sewer System	10-40
Gas System	5-40
Buildings and Improvements	15-40
Machinery, Equipment and Vehicles	5-12
Infrastructure	15-20

h. **Compensated Absences**

It is the City's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the City does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds when the individual is eligible for the benefit.

i. **Long-term Obligations**

In the government-wide financial statements and proprietary fund type financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable business-type activities or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

j. **Fund Equity**

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

- Nonspendable fund balance - amounts that are not in spendable form (such as inventory) or are required to be maintained intact.
- Restricted fund balance - amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government), through constitutional provisions, or by enabling legislation.
- Committed fund balance - amounts constrained to specific purposes by the City itself, using its highest level of decision-making authority (i.e., City Council). To be reported as committed, amounts cannot be used for any other purpose unless the City takes the same highest level action to remove or change the constraint.

**CITY OF SPLENDORA, TEXAS**  
*NOTES TO THE FINANCIAL STATEMENTS*  
*FOR THE YEAR ENDED SEPTEMBER 30, 2011*

- Assigned fund balance - amounts the City intends to use for a specific purpose. Intent can be expressed by the City Council or by an official or body to which the City Council delegates the authority.
- Unassigned fund balance - amounts that are available for any purpose. Positive amounts are reported only in the general fund.

Beginning fund balances for the City's governmental funds have been restated to reflect the above classifications.

The City Council establishes (and modifies or rescinds) fund balance commitments by passage of a resolution. This is typically done through adoption and amendment of the budget. A fund balance commitment is further indicated in the budget document as a designation or commitment of the fund (such as for special incentives). Assigned fund balance is established by the City Secretary or her designee through adoption or amendment of the budget as intended for specific purpose (such as the purchase of fixed assets, construction, debt service, or for other purposes).

k. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of management's estimates. Actual results could differ from those estimates.

**B. Stewardship, Compliance and Accountability**

1. Budgetary Information

The following procedures are followed in establishing the budgetary data reflected in the basic financial statements:

- a. Prior to the beginning of the fiscal year, the City prepares a budget for the next succeeding fiscal year. The operating budget includes proposed expenditures and the means of financing them.
- b. A meeting of the City Council is then called for the purpose of adopting the proposed budget. At least ten days' public notice of the meeting must have been given.
- c. Prior to the start of the fiscal year, the budget is legally enacted through passage of a resolution by the City Council.

Once a budget is approved, it can be amended only by approval of a majority of the members of the City Council. As required by law, such amendments are made before the fact, are reflected in the official minutes of the City Council and are not made after fiscal year end. During the year, the budget was not amended. All budget appropriations lapse at year end.

2. For the year ended September 30, 2011, the general fund expenditures exceeded its appropriations in the following departments:

	<u>Appropriations</u>	<u>Expenditures</u>	<u>Excess</u>
None			

**CITY OF SPLENDORA, TEXAS**  
 NOTES TO THE FINANCIAL STATEMENTS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2011

**C. Deposits and Investments**

The City's investments consist of certificates of deposit which are insured and collateralized as required by City policy.

*Interest rate risk.* Interest rate risk is the risk that changes in interest rates may adversely affect the value of the investments. The City monitors interest rate risk utilizing weighted average maturity analysis. In accordance with its investment policy, the City reduces its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio as a whole to no more than 180 days, diversification, and by holding securities to maturity.

*Credit risk.* For fiscal year 2011, the City invested in certificates of deposit at the local depository which are not exposed to credit risk due to they are insured and collateralized by securities pledged by the depository bank.

*Concentration of credit risk.* The City's investment policy does not limit an investment in any one issuer.

*Custodial credit risk – deposits.* In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. As of September 30, 2011, the City's bank balance of \$1,763,901 was not exposed to custodial credit risk because it was insured and collateralized with securities held by the Bank's agent and in the City's name.

*Custodial credit risk – investments.* For an investment, this is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City is not exposed to custodial risk due to the investments are certificates of deposit with the local bank depository and are adequately collateralized by the Bank's agent in the City's name.

**D. Receivables**

Primary Government:

Receivables as of year end for the City's individual major governmental and proprietary funds, including the applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Water, Sewer and Gas Fund</u>	<u>Total</u>
<b>Receivables:</b>			
Property Taxes	\$ 19,409	\$ -	\$ 19,409
Accounts	-	228,924	228,924
Intergovernmental	17,235	136,969	154,204
Gross Receivables	<u>36,644</u>	<u>365,893</u>	<u>402,537</u>
Less: Allowance for Uncollectible	(776)	(43,250)	(44,026)
<b>Net Total Receivables</b>	<u><u>\$ 35,868</u></u>	<u><u>\$ 322,643</u></u>	<u><u>\$ 358,511</u></u>

*Governmental funds report deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period or in connection with resources that have been received but not yet earned. At the end of the current fiscal year, the various components of deferred revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Delinquent Property Taxes Receivable (General Fund)	\$ 18,633	\$ -
<b>Total Deferred/Unearned Revenue For Governmental Funds</b>	<u><u>\$ 18,633</u></u>	<u><u>\$ -</u></u>

**CITY OF SPLENDORA, TEXAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

**E. Capital Assets**

Capital asset activity for the period ended September 30, 2011, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<b>Governmental Activities:</b>				
<b>Capital Assets, not being Depreciated:</b>				
Land	\$ 37,260	\$ -	\$ -	\$ 37,260
<i>Total Capital Assets, not being Depreciated</i>	<u>37,260</u>	<u>-</u>	<u>-</u>	<u>37,260</u>
 <b>Capital Assets, being Depreciated:</b>				
Building and Improvements	453,158	-	-	453,158
Machinery, Equipment and Vehicles	338,602	-	-	338,602
Infrastructure	108,743	-	-	108,743
<i>Total Capital Assets, being Depreciated</i>	<u>900,503</u>	<u>-</u>	<u>-</u>	<u>900,503</u>
 <b>Less Accumulated Depreciation for:</b>				
Building and Improvements	(241,344)	(14,758)	-	(256,102)
Machinery, Equipment and Vehicles	(206,422)	(40,358)	-	(246,780)
Infrastructure	(30,974)	(7,109)	-	(38,083)
<i>Total Accumulated Depreciation</i>	<u>(478,740)</u>	<u>(62,225)</u>	<u>-</u>	<u>(540,965)</u>
 <i>Total Capital Assets, being Depreciated, net</i>	 <u>421,763</u>	 <u>(62,225)</u>	 <u>-</u>	 <u>359,538</u>
 <i>Governmental Activities Capital Assets, net</i>	 <u>\$ 459,023</u>	 <u>\$ (62,225)</u>	 <u>\$ -</u>	 <u>\$ 396,798</u>

Depreciation was charged to departments as follows:

General Government	\$ 16,725
Public Safety	38,392
Highway and Streets	6,686
Culture and Recreation	422
<i>Total</i>	<u>\$ 62,225</u>

**CITY OF SPLENDORA, TEXAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<b>Business-type Activities:</b>				
<b>Capital Assets, not being Depreciated:</b>				
Land	\$ -	\$ -	\$ -	\$ -
Construction in Progress	-	6,548	-	6,548
<b>Total Capital Assets, not being Depreciated</b>	<b>-</b>	<b>6,548</b>	<b>-</b>	<b>6,548</b>
<b>Capital Assets, being Depreciated:</b>				
Water System	2,754,042	670,602	-	3,424,644
Sewer System	4,827,068	-	-	4,827,068
Gas System	1,070,253	-	-	1,070,253
Buildings and Improvements	8,150	-	-	8,150
Machinery, Equipment and Vehicles	258,099	5,150	-	263,249
<b>Total Capital Assets, being Depreciated</b>	<b>8,917,612</b>	<b>675,752</b>	<b>-</b>	<b>9,593,364</b>
<b>Less Accumulated Depreciation for:</b>				
Water System	(1,615,110)	(72,828)	-	(1,687,938)
Sewer System	(1,282,473)	(141,208)	-	(1,423,681)
Gas System	(529,089)	(34,034)	-	(563,123)
Buildings and Improvements	(4,255)	(543)	-	(4,798)
Machinery, Equipment and Vehicles	(217,925)	(8,669)	-	(226,594)
<b>Total Accumulated Depreciation</b>	<b>(3,648,852)</b>	<b>(257,282)</b>	<b>-</b>	<b>(3,906,134)</b>
<b>Total Capital Assets, being Depreciated, net</b>	<b>5,268,760</b>	<b>418,470</b>	<b>-</b>	<b>5,687,230</b>
<b>Business-type Activities Capital Assets, net</b>	<b>\$ 5,268,760</b>	<b>\$ 425,018</b>	<b>\$ -</b>	<b>\$ 5,693,778</b>

Depreciation was charged to business-type activities as follows:

Administration	\$ 543
Water	75,717
Sewer	144,098
Gas	36,924
<b>Total</b>	<b>\$ 257,282</b>

**F. Interfund Balances and Activity**

1. Due To and From Other Funds at September 30, 2011, consisted of the following:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
None		

If outstanding balances exist between funds, they result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

2. Transfers To and From Other Funds at September 30, 2011, consisted of the following:

<u>Transfers From</u>	<u>Transfers To</u>	<u>Amount</u>	<u>Reason</u>
Utility Fund	General Fund	\$ 30,000	Appropriations

Interfund transfers are defined as "flows of assets without equivalent flow of assets in return and without a requirement for repayment."

**CITY OF SPLENDORA, TEXAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

**G. Long-Term Obligations**

The City's long-term liabilities consist of notes payable, revenue bonds, certificates of obligation, and capital lease agreements. The requirements for certificates of obligation, revenue bonds, and capital lease principal and interest payments are accounted for in the Water, Sewer, and Gas Fund. The requirements for notes payable principal and interest payments are accounted for in the General Fund.

1. Long-term Obligation Activity

Long-term obligations include notes payable, certificates of obligation, revenue bonds, and a capital lease. Changes in long-term obligations for the period ended September 30, 2011, are as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
<i>Governmental Activities:</i>					
Notes Payable	\$ 10,376	\$ -	\$ 10,376	\$ -	\$ -
<b>Total Governmental Activities</b>	<b>\$ 10,376</b>	<b>\$ -</b>	<b>\$ 10,376</b>	<b>\$ -</b>	<b>\$ -</b>
<i>Business-type Activities:</i>					
Certificates of Obligation	\$ 3,200,000	\$ -	\$ 30,000	\$ 3,170,000	\$ 30,000
Revenue Bonds	1,005,000	-	180,000	825,000	190,000
Capital Lease	-	505,500	43,450	462,050	64,586
<b>Total Business-type Activities</b>	<b>\$ 4,205,000</b>	<b>\$ 505,500</b>	<b>\$ 253,450</b>	<b>\$ 4,457,050</b>	<b>\$ 284,586</b>

2. Certificates of Obligation

The City issues certificates of obligation to provide funds for the construction and improvement of the City's water, sewer, and gas systems. Principal and interest payments on the City's debt are secured by ad valorem property taxes levied on all taxable property within the city limits and further secured by a subordinate lien on a pledge of net revenues from the operation of the City's water and sewer systems.

The following is a summary of changes in the certificates of obligation for the fiscal year:

<u>Series</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Original Issue</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
2003	5.47%	2024	2,295,000	\$ 2,295,000	\$ -	\$ -	\$ 2,295,000
2009	5.00%	2024	905,000	905,000	-	30,000	875,000
<b>Totals</b>				<b>\$ 3,200,000</b>	<b>\$ -</b>	<b>\$ 30,000</b>	<b>\$ 3,170,000</b>

**CITY OF SPLENDORA, TEXAS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

Debt service requirements on certificates of obligation at September 30, 2011, are as follows:

<u>Year Ending September 30,</u>	<u>Business-type Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 30,000	\$ 169,410	\$ 199,410
2013	30,000	167,910	197,910
2014	30,000	166,410	196,410
2015	30,000	164,910	194,910
2016	270,000	156,385	426,385
2017	285,000	140,410	425,410
2018	300,000	123,560	423,560
2019	320,000	106,310	426,310
2020	335,000	89,080	424,080
2021	355,000	71,178	426,178
2022	95,000	52,110	147,110
2023	100,000	31,998	131,998
2024	990,000	10,840	1,000,840
<b>Totals</b>	<b>\$ 3,170,000</b>	<b>\$ 1,450,511</b>	<b>\$ 4,620,511</b>

3. Revenue Bonds

The City also issues revenue bonds to provide funds for the construction and improvement of the City's water, sewer, and gas systems. The City pledges the net revenues of the water, sewer, and gas systems for payment of principal and interest on the revenue bonds, which are equally secured by a first lien on the City's combined water, sewer, and gas systems.

The following is a summary of changes in the revenue bonds for the fiscal year:

<u>Series</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Original Issue</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
2002	5.00%	2015	\$ 2,155,000	\$ 1,005,000	\$ -	\$ 180,000	\$ 825,000
<b>Totals</b>				<b>\$ 1,005,000</b>	<b>\$ -</b>	<b>\$ 180,000</b>	<b>\$ 825,000</b>

Debt service requirements on revenue bonds at September 30, 2011, are as follows:

<u>Year Ending September 30,</u>	<u>Business-type Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 190,000	\$ 36,500	\$ 226,500
2013	200,000	26,750	226,750
2014	210,000	16,500	226,500
2015	225,000	5,625	230,625
<b>Totals</b>	<b>\$ 825,000</b>	<b>\$ 85,375</b>	<b>\$ 910,375</b>

4. Capital Lease

The City has entered into a lease agreement as lessee for financing the acquisition of water meters. This lease agreement qualifies as a capital lease for accounting purpose and therefore, has been recorded at present value of its future minimum lease payment as of inspection date.

The asset acquired through capital lease is as follows:

<u>Asset</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Original Issue</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Water Meters	4.435%	2018	\$ 505,500	\$ -	\$ 505,500	\$ 43,450	\$ 462,050
<b>Totals</b>				<b>\$ -</b>	<b>\$ 505,500</b>	<b>\$ 43,450</b>	<b>\$ 462,050</b>

**CITY OF SPLENDORA, TEXAS**  
 NOTES TO THE FINANCIAL STATEMENTS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2011

Capital lease requirements at September 30, 2011 are as follows:

<u>Year Ending September 30,</u>	<u>Capital Lease Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 64,586	\$ 19,234	\$ 83,820
2013	67,563	16,257	83,820
2014	70,621	13,199	83,820
2015	73,816	10,004	83,820
2016	77,138	6,682	83,820
2017	80,647	3,173	83,820
2018	27,679	262	27,941
<b>Totals</b>	<b>\$ 462,050</b>	<b>\$ 68,811</b>	<b>\$ 530,861</b>

5. Notes Payable

The City issued notes payable to provide funds for the purchase of police vehicles. The notes payable are secured by the respective vehicle purchased with the loan proceeds. The notes are issued as 2 year current interest notes.

The following is a summary of changes in the notes payable for the fiscal year:

<u>Description</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Original Issue</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Ford Motor Credit	6.90%	2011	\$ 31,175	\$ 10,376	\$ -	\$ 10,376	\$ -
<b>Totals</b>				<b>\$ 10,376</b>	<b>\$ -</b>	<b>\$ 10,376</b>	<b>\$ -</b>

H. Other Information

1. Risk Management

The City is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees, and natural disasters. During fiscal year 2011, the City purchased workers compensation and property and liability insurance at a cost that is considered to be economically justifiable by joining together with other governmental entities in the State as a member of the Texas Municipal League Intergovernmental Risk Pool ("TML"). TML is a self-funded pool operating as a common risk management and insurance program. The City pays an annual premium to TML for its above insurance coverages. The agreement for the formation of TML provides that TML will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of acceptable risk levels; however, each category of coverage has its own level of reinsurance. The City continues to carry commercial insurance for other risks of loss. There were no significant reductions in insurance coverages in the past fiscal year and settled claims resulting from these risks have not exceeded coverage in any of the past three fiscal years.

2. Contingencies

The general revenues of the City are contingently liable for the \$3,170,000 payable in Certificates of Obligation, which are currently outstanding and recorded as obligations of the Water, Sewer, and Gas enterprise fund. The full faith credit of the City is pledged to redeem these certificates if revenues from the water, sewer, and gas enterprise fund are not insufficient to meet the obligations.

From time to time, the City is a defendant in legal proceedings relating to its operations as a City. In the best judgment of the City's management, the outcome of any present legal proceedings will not have any adverse material effect on the accompanying financial statements.

**CITY OF SPLENDORA, TEXAS**  
*NOTES TO THE FINANCIAL STATEMENTS*  
*FOR THE YEAR ENDED SEPTEMBER 30, 2011*

**I. Pension Plan (Defined Contribution)**

The City provides pension benefits for all of its full-time employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees who have three months of service with the City are allowed to voluntarily participate in the plan. The City requires employees who elect to participate in the plan contribute a minimum annual contribution of \$300 and contributions are not to exceed amounts permitted by the Internal Revenue Code and Regulations. The City's contribution for participating employees and interest allocated to the employee's account are vested upon a five year graded vesting schedule. During the past year, the City contributed a match up to 4% of gross salary which totaled \$12,198 and employees contributed \$12,198.

**OTHER SUPPLEMENTARY INFORMATION**

**CITY OF SPLENDORA, TEXAS**  
SUMMARY OF TAXES RECEIVABLE  
FOR THE YEAR ENDED SEPTEMBER 30, 2011

**SCHEDULE B-1**

<u>Tax Year</u>	<u>Balance 9/30/2010</u>	<u>Tax Levy</u>	<u>Collections</u>	<u>Adjustments</u>	<u>Balance 9/30/2011</u>
2010	\$ -	\$ 125,743	\$ 120,345	\$ 602	\$ 6,000
2009	5,212	-	2,413	(42)	2,757
2008	2,956	-	928	496	2,524
2007	1,662	-	247	(65)	1,350
2006	889	-	236	27	680
2005	959	-	215	(24)	720
2004	890	-	187	(23)	680
2003	849	-	182	-	667
2002	1,339	-	94	-	1,245
2001 & Prior	3,232	-	328	(118)	2,786
<b>Total</b>	<b>\$ 17,988</b>	<b>\$ 125,743</b>	<b>\$ 125,175</b>	<b>\$ 853</b>	<b>\$ 19,409</b>
Less Allowance for Uncollectible Accounts					(776)
					<b>\$ 18,633</b>

**ASSESSED VALUATION SUMMARY**

<u>Tax Year</u>	<u>Property Valuations</u>	<u>Tax Rate Per \$100 Valuation</u>
2010	\$ 42,366,240	.2968
2009	41,421,760	.2978
2008	36,628,351	.2984
2007	32,344,162	.2955
2006	28,801,793	.3000
2005	28,326,740	.3000
2004	21,894,273	.3000
2003	21,559,208	.3000
2002	19,445,288	.3000
2001	18,877,804	.3000

**CITY OF SPLENDORA, TEXAS**  
**INSURANCE COVERAGE**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2011**

**SCHEDULE B-2**

<u>Type of Coverage</u>	<u>From</u>	<u>To</u>	<u>Coverage</u>	<u>Insurer</u>
General Liability	10/01/10	10/01/11	\$1,000,000	Texas Municipal League
Automobile Liability	10/01/10	10/01/11	1,000,000	Texas Municipal League
Law Enforcement Liability	10/01/10	10/01/11	1,000,000	Texas Municipal League
Errors and Omissions Liability	10/01/10	10/01/11	1,000,000	Texas Municipal League
Workers' Compensation	10/01/10	10/01/11	Statutory	Texas Municipal League
Real and Personal Property	10/01/10	10/01/11	3,662,551	Texas Municipal League
Mobile Equipment	10/01/10	10/01/11	137,690	Texas Municipal League
Boiler and Machinery	10/01/10	10/01/11	450,000	Texas Municipal League
Surety Bond - Employee Dishonesty	09/01/05	Until Cancelled	10,000	Western Surety

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**OVERALL COMPLIANCE AND INTERNAL CONTROL SECTION**

# HLSK

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## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Honorable Mayor and Members of City Council  
City of Splendora, Texas  
P.O. Box 1087  
Splendora, Texas 77372

The Honorable Mayor and Members of City Council:

We have audited the financial statements of the governmental activities, the business-type activities and each major fund of City of Splendora, Texas (City), as of and for the year ended September 30, 2011, which collectively comprise the City's basic financial statements and have issued our report thereon dated February 20, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weakness, as defined above.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, City Council, others within the entity, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

*Hereford, Lynch, Sellars & Kirkham, P.C.*

**HEREFORD, LYNCH, SELLARS & KIRKHAM, P.C.**  
Certified Public Accountants

**Conroe, Texas**  
**February 20, 2012**

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**CITY OF SPLENDORA, TEXAS**  
*SCHEDULE OF FINDINGS AND RESPONSES*  
*FOR THE YEAR ENDED SEPTEMBER 30, 2011*

<b>SECTION I – SUMMARY OF AUDITORS’ RESULTS</b>	
<b>FINANCIAL STATEMENTS</b>	
1. Type of auditors’ report issued	Unqualified
2. Internal Control over Financial Reporting:	
a. Significant Deficiencies identified that are <u>not considered</u> to be material weaknesses?	None
b. Material Weaknesses identified?	None
3. Noncompliance material to the Financial Statements?	None
<b>SECTION II – FINDINGS RELATED TO FINANCIAL STATEMENTS</b>	
<b>1. FINDINGS RELATED TO INTERNAL CONTROL OVER FINANCIAL REPORTING</b>	
None	
<b>2. FINDINGS RELATED TO COMPLIANCE WITH LAWS AND REGULATIONS</b>	
None	