OFFICIAL STATEMENT DATED AS OF JULY 26, 2007

NEW ISSUES — BOOK-ENTRY ONLY **RATINGS: SEE "RATINGS" HEREIN**

In the opinion of Co-Bond Counsel, assuming compliance with certain covenants and based on certain representations, (i) interest on the Series 2007B Bonds is excludable from gross income for federal income tax purposes under existing law, (ii) interest on the Series 2007B Bonds is not an item of tax preference includable in alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on individuals. See "Tax Exemption" herein for a discussion of Co-Bond Counsel's opinion, including a description of alternative minimum tax consequences for corporations holding Series 2007B Bonds.

$298,670,000
CITY OF HOUSTON, TEXAS
Airport System
Subordinate Lien Revenue Refunding Bonds
Series 2007B (Non-AMT)

Interest Accrual Date: Date of Delivery **CUSIP Prefix:** 442348 **Due:** July 1

This Official Statement is provided to furnish information in connection with the offering by the City of Houston, Texas (the "City") of its Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007B (Non-AMT) (the "Series 2007B Bonds" or the "Non-AMT Bonds" or the "Bonds"). The Bonds are special obligations of the City that, together with the Outstanding Subordinate Lien Bonds and any Additional Subordinate Lien Bonds hereafter issued, are payable from and equally and ratably secured by a lien on the Net Revenues of the Houston Airport System, subject and subordinate to any prior and superior lien of Outstanding Senior Lien Bonds and Additional Senior Lien Bonds, all as defined and provided in the ordinances authorizing the issuance of such bonds, and certain funds established pursuant to such ordinances. See "APPENDIX H–THE ORDINANCE."

Proceeds of the sale of the Series 2007B Bonds will be used to refund and defease certain outstanding airport system bonds and a portion of certain airport system senior lien commercial paper notes of the City (as further described in Appendix A) and to pay costs of issuance of the Series 2007B Bonds. See "APPENDIX A–SCHEDULE OF REFUNDED OBLIGATIONS."

Interest on the Bonds will accrue from their date of delivery until maturity or prior redemption and is payable semi-annually on each January 1 and July 1 commencing January 1, 2008. Wells Fargo Bank, N.A. (the "Paying Agent/Registrar") is the initial Paying Agent/Registrar.

The Bonds, when issued, will be registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds, until DTC resigns or is discharged. The Bonds will be available to purchasers only in book-entry form. For as long as Cede & Co. is the exclusive registered owner of the Bonds, the principal of and interest on the Bonds will be payable by the Paying Agent/Registrar to DTC, which will be responsible for making such payments to DTC Participants for subsequent remittance to the owners of beneficial interests in the Bonds. The purchasers of the Bonds will not receive certificates representing their beneficial ownership interests therein.

THE BONDS DO NOT CONSTITUTE AN INDEBTEDNESS OR GENERAL OBLIGATION OF THE CITY. OWNERS OF THE BONDS SHALL NEVER HAVE THE RIGHT TO DEMAND PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE BONDS FROM ANY FUNDS RAISED OR TO BE RAISED BY TAXATION.

The scheduled payment of principal and interest on the Series 2007B Bonds when due will be guaranteed under a municipal bond insurance policy to be issued by Financial Guaranty Insurance Company ("FGIC") concurrently with the delivery of the Series 2007 B Bonds.

The Bonds are subject to mandatory and optional redemption prior to maturity, as described herein. See "THE BONDS–Optional Redemption" and "THE BONDS–Mandatory Redemption."

SEE INSIDE COVER PAGES FOR MATURITY, PRICING SCHEDULE, AND CUSIP NUMBERS

This cover page is not intended to be a summary of the terms of, or the security for, the Bonds. Investors are advised to read the Official Statement in its entirety to obtain information essential to the making of an informed investment decision.

The Bonds are offered by the Underwriters listed below when, as and if issued by the City and accepted by the Underwriters, subject to the approving opinions of the Attorney General of the State of Texas and Vinson & Elkins L.L.P., Houston, Texas, and Bates & Coleman, P.C., Houston, Texas, Co-Bond Counsel for the City, as to the validity of the issuance of the Bonds under the Constitution and the laws of the State of Texas. Certain matters will be passed upon for the City by its Special Disclosure Co-Counsel, Fulbright & Jaworski L.L.P., Houston, Texas and Escamilla & Poneck, Inc., Houston, Texas. Certain other legal matters will be passed upon for the Underwriters by their counsel, Winstead, PC, Houston, Texas. The Bonds are expected to be available for delivery through the facilities of DTC on or about September 12, 2007.

UBS Investment Bank

Citi **J.P. Morgan** **Ramirez & Co., Inc.**

First Albany Capital Inc. Loop Capital Markets, LLC Merrill Lynch & Co. Southwest Securities, Inc.

MATURITY AND PRICING SCHEDULE

$298,670,000
CITY OF HOUSTON, TEXAS
Airport System Subordinate Lien Revenue Refunding Bonds
Series 2007B (Non-AMT)

Maturity (July 1)	Principal Amount	Interest Rate	Initial Yield	CUSIP No.[1]
2008	$ 760,000	4.500%	3.750%	442348X94
2009	1,545,000	4.000	3.800	442348Y28
2010	1,605,000	4.000	3.850	442348Y36
2011	1,670,000	4.000	3.900	442348Y44
2012	3,465,000	4.000	3.950	442348Y51
2013	3,600,000	4.000	4.000	442348Y69
2014	3,745,000	4.000	4.060	442348Y77
2015	450,000	4.100	4.120	442348Y85
2015	3,440,000	5.000	4.120	442348Y93
2016	850,000	4.125	4.180	442348Z27
2016	3,225,000	5.000	4.180	442348Z35
2017	250,000	4.250	4.250	442348Z43
2017	4,020,000	5.000	4.250	442348Z50
2018	8,715,000	5.000	4.350*	442348Z68
2019	9,960,000	5.000	4.380*	442348Z76
2020	10,450,000	5.000	4.410*	442348Z84
2021	520,000	4.500	4.500	442348Z92
2021	4,585,000	5.000	4.440*	4423482A5
2022	10,020,000	5.000	4.480*	4423482B3
2023	2,650,000	5.000	4.510*	4423482C1
2024	150,000	4.600	4.620	4423482D9
2024	2,635,000	5.000	4.540*	4423482E7
2025	19,075,000	5.000	4.570*	4423482F4
2026	20,030,000	5.000	4.590*	4423482G2
2027	21,030,000	5.000	4.610*	4423482H0

$160,225,000 Term Bonds

$160,225,000 5.00% Term Bonds Due July 1, 2032[2] Initial Yield 4.670%* CUSIP No. 4423482J6[1]

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[1] CUSIP numbers for the Bonds have been assigned by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. and are included solely for the convenience of the owners of the Bonds. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP. Neither the City, the co-Financial Advisors, nor the Underwriters are responsible for the selection or correctness of the CUSIP numbers set forth herein.
[2] Subject to mandatory sinking fund redemption as described in "THE BONDS—Mandatory Redemption."
* Yield to first optional call date. See "THE BONDS—Optional Redemption."

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACT. THE REGISTRATION OR QUALIFICATION OF THE BONDS IN ACCORDANCE WITH APPLICABLE PROVISIONS OF SECURITIES LAW OF THE STATES IN WHICH THE BONDS HAVE BEEN REGISTERED OR QUALIFIED AND THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN OTHER STATES CANNOT BE REGARDED AS A RECOMMENDATION THEREOF. THE BONDS HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

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

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

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

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

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

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City of Houston, Texas

ELECTED OFFICIALS
Bill White, Mayor
Annise D. Parker, City Controller

CITY COUNCIL

Council Member, District A .... Toni Lawrence
Council Member, District B .... Jarvis Johnson
Council Member, District C .... Anne Clutterbuck
Council Member, District D .... Ada Edwards
Council Member, District E .... Addie Wiseman
Council Member, District F .... M.J. Khan
Council Member, District G .... Pam Holm
Council Member, District H .... Adrian Garcia
Council Member, District I .... Carol Alvarado
Council Member, At-Large Position 1 .... Peter Brown
Council Member, At-Large Position 2 .... Sue Lovell
Council Member, At-Large Position 3 .... Melissa Noriega
Council Member, At-Large Position 4 .... Ronald C. Green
Council Member, At-Large Position 5 .... Michael Berry

APPOINTED OFFICIALS

Chief Administrative Officer .... Anthony W. Hall, Jr.
City Attorney .... Arturo G. Michel
Director, Department of Finance and Administration .... Judy Gray Johnson
Director, Houston Airport System .... Richard M. Vacar
City Secretary .... Anna Russell

ADVISORS AND CONSULTANTS

Co-Financial Advisors .... First Southwest Company
Estrada Hinojosa & Company, Inc.

Co-Bond Counsel .... Vinson & Elkins L.L.P.
Bates & Coleman, P.C.

Special Disclosure Co-Counsel .... Fulbright & Jaworski L.L.P.
Escamilla & Poneck, Inc.

FINANCING WORKING GROUP

Houston Airport System .... Sara Culbreth
David Arthur
Ellen Erenbaum

Office of the City Attorney .... Susan T. Taylor
Gary L. Wood

Department of Finance & Administration .... Michael Shannon
Charles R. Leal
Asha Patnaik

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

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OFFICIAL STATEMENT

$298,670,000
CITY OF HOUSTON, TEXAS
Airport System
Subordinate Lien Revenue Refunding Bonds
Series 2007B (Non-AMT)

INTRODUCTION

This Official Statement, including the cover page and schedules hereto, is provided to furnish information regarding the offer and sale by the City of Houston, Texas of its Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007B (Non-AMT) (the "Series 2007B Bonds," the "Non-AMT Bonds," or "the Bonds"). The Bonds are issued pursuant to Chapters 1201, 1207, 1371, and 1503, Texas Government Code, as amended (collectively, the "Act"), an ordinance adopted by the City Council of the City on March 7, 2007 (the "Ordinance"), and an Officers Pricing Certificate authorized by such Ordinance.

The Houston Airport System includes the following facilities, each of which the City owns and operates: George Bush Intercontinental Airport/Houston ("Intercontinental"); William P. Hobby Airport ("Hobby"); and Ellington Field ("Ellington"). Continental Airlines, Inc. ("Continental") is the dominant air carrier operating at Intercontinental and Southwest Airlines, Inc. ("Southwest") is the dominant air carrier operating at Hobby. The City manages and operates the Houston Airport System as an enterprise system of the City. For additional information about the Houston Airport System, see "THE HOUSTON AIRPORT SYSTEM."

The City is the fourth largest city in the nation and the largest city in Texas. In July 2006, according to the U.S. Census Bureau, the City's population was approximately 2.14 million, and the population of the 10-county metropolitan statistical area ("MSA") was approximately 5.54 million, which is the sixth largest in the United States. For additional information about the City, see "THE CITY OF HOUSTON AND CITY FINANCIAL INFORMATION" and "APPENDIX G—Economic and Demographic Characteristics."

Brief descriptions and summaries of the Bonds, the Houston Airport System and the Ordinance are included in this Official Statement. References herein to the Bonds and the Ordinance are qualified in their entirety by reference to the Ordinance and the forms of the respective Series of Bonds included therein. A glossary of defined terms is included as APPENDIX H, and unless otherwise specifically defined, capitalized terms used herein have the meanings set out in APPENDIX H. Houston Airport System Fund financial statements of the City of Houston, Texas are included in APPENDIX B.

PURPOSE AND PLAN OF FINANCING

The Series 2007B Bonds

Proceeds of the sale of the Series 2007B Bonds will be used to refund and defease a portion of the City's outstanding Airport System senior lien commercial paper notes (the "Series 2007B Refunded Notes" or the "Refunded Notes"), and a portion of the City's Subordinate Lien Bonds (as more specifically described in APPENDIX A and referred to herein as the "Refunded Bonds") and pay the costs of such issuance and refunding. See "Appendix A–Schedule of Refunded Obligations."

The Refunded Obligations

The Refunded Notes

A portion of the proceeds of the Bonds, together with other available funds, if any, will be used to purchase a portfolio of obligations authorized under Texas law (the "Refunded Note Escrowed Securities") to be deposited in escrow (the "Refunded Note Escrow Fund") with U.S. Bank, National Association (the "Refunded Notes Escrow Agent"), the maturing principal of and interest on which will be sufficient together with other funds to pay, when due, the principal of and interest on the Refunded Notes.

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

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

The Refunded Bonds

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

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

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

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

ADDITIONAL FINANCING

The City is expected to issue a separate series of bonds to be designated as the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007A (AMT) in the approximate amount of $55,000,000 (the "Series 2007A Bonds") to refund and defease a portion of the City's outstanding airport system senior lien commercial paper notes. Pricing of the Series 2007A Bonds will be subject to market conditions and is expected to occur on or about August 14, 2007.

SOURCES AND USES OF FUNDS

The following table summarizes the estimated sources and uses of proceeds of the Bonds and certain other available funds:

Sources of Funds:	
Principal Amount of the Bonds	$298,670,000.00
Net Original Issue Premium	8,902,741.40
Issuer Contribution	3,118,727.11
Total Sources of Funds	$310,691,468.51
Uses of Funds:	
Deposit to Refunded Note Escrow Fund	$ 43,236,788.99
Deposit to Refunded Bond Escrow Fund	263,826,434.66
Underwriters' Discount	1,411,806.12
Costs of Issuance[1]	2,216,438.74
Total Uses of Funds	$310,691,468.51

[1] Includes legal fees, insurance premiums, surety premiums, financial advisory fees, rating agency fees, fees of the Paying Agent/Registrar, and other costs of issuance.

THE BONDS

Description

The Bonds will mature in the aggregate principal amounts and on the dates indicated on the inside cover page of this Official Statement. The Bonds will be dated as set forth in the Ordinance authorizing such issuance and the Officers Pricing Certificate authorized by such Ordinance and will accrue interest from the date of delivery. Interest on the Bonds will be payable each January 1 and July 1, commencing January 1, 2008, until maturity or earlier redemption. Wells Fargo Bank, N.A., Houston, Texas, is the initial paying agent/registrar (the "Paying Agent/Registrar") for the Bonds. The Bonds will be issued in fully registered form in denominations of $5,000 or any integral multiple thereof.

Principal of the Bonds is payable upon presentation and surrender thereof at the principal payment office of the Paying Agent/Registrar, which is currently located in Houston, Texas. Interest on the Bonds will be payable to the registered owner whose name appears in the registration books for the Bonds (the "Register") maintained by the Paying Agent/Registrar at the close of business on the 15th day of the calendar month immediately preceding the applicable interest payment date (the "Record Date") and shall be payable by the Paying Agent/Registrar (i) by check sent by United States Mail, first class postage prepaid, to the address of the registered owner recorded in the Register or (ii) by such other method, acceptable to the Paying Agent/Registrar, requested by, and at the risk and expense of, the registered owner. Accrued interest payable at maturity of the Bonds will be paid upon presentation and surrender of such Bonds at the principal payment office of the Paying Agent/Registrar.

Ownership

The City, the Paying Agent/Registrar, and any other person may treat the person in whose name any Bond is registered as the absolute Owner of such Bond for the purpose of making and receiving payment of the principal thereof and premium, if any, thereon, and for the further purpose of making and receiving payment of the interest thereon, and for all other purposes, whether or not such Bond is overdue, and neither the City nor the Paying Agent/Registrar 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 Ordinance shall be valid and effectual and shall discharge the liability of the City and the Paying Agent/Registrar upon such Bond to the extent of the sums paid.

Transfers and Exchanges

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

So long as any Bonds remain Outstanding, the Paying Agent/Registrar shall keep the Register at its principal corporate trust office in which, subject to such reasonable regulations as it may prescribe, the Paying Agent/Registrar shall provide for the registration and transfer of the Bonds in accordance with the terms of the Ordinance. A copy of the Register shall be maintained at an office of the Paying Agent/Registrar in Texas.

Each Bond shall be transferable only upon the presentation and surrender thereof at the principal corporate trust office of the Paying Agent/Registrar, duly endorsed for transfer, or accompanied by an assignment duly executed by the Registered Owner or his authorized representative in form satisfactory to the Paying Agent/Registrar. Upon due presentation and surrender of any Bond for transfer, the Paying Agent/Registrar is required to authenticate and deliver in exchange therefor, within 72 hours after such presentation and surrender, a new Bond or Bonds, registered in the name of the transferee or transferees, in authorized denominations and of the same maturity and aggregate principal amount and bearing interest at the same rate as the Bond or Bonds so presented and surrendered.

In the event the Bonds are not in the DTC book-entry only registration system, all Bonds shall be exchangeable upon the presentation and surrender thereof at the principal corporate trust office of the Paying Agent/Registrar for the Bonds of the same series of the same maturity and interest rate and in any authorized denomination, in an aggregate principal amount equal to the unpaid principal amount of the Bond or Bonds presented for exchange.

Each Bond delivered in accordance with the Ordinance shall be entitled to the benefits and security of the Ordinance to the same extent as the Bond or Bonds in lieu of which such Bond is delivered.

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

The Paying Agent/Registrar shall not be required to transfer or exchange any Bond during the 45-day period prior to the date fixed for redemption; provided, however, that such restrictions shall not apply to the transfer or exchange by the Registered Owner of the unredeemed portion of any Bond called for redemption in part.

Optional Redemption

Series 2007B Bonds

The Series 2007B Bonds maturing on and after July 1, 2018, are subject to optional redemption prior to maturity, in whole or in part, on July 1, 2017, or any date thereafter, at 100% of the principal amount thereof, plus accrued interest to the redemption date.

Mandatory Redemption

Series 2007B Bonds

The Series 2007B Bonds maturing on July 1, 2032 (the "Series 2007B Term Bonds" or the "Term Bonds") are being issued as term bonds and are subject to mandatory sinking fund redemption prior to their scheduled maturity, and will be redeemed by the City at a redemption price equal to the principal amount thereof, plus interest accrued thereon to the date of redemption, on the dates and in the amounts shown in the following schedule:

$160,225,000 Term Bonds
Due July 1, 2032

Mandatory Sinking Fund Redemption Date (July 1)	Mandatory Sinking Fund Redemption Amount
2028	$22,080,000
2029	64,680,000
2030	67,920,000
2031	2,705,000
2032	2,840,000

The particular Series 2007B Term Bonds to be redeemed shall be selected by the Paying Agent/Registrar by lot or other customary random selection method. The principal amount of Series 2007B Term Bonds to be mandatorily redeemed in each year shall be reduced by the principal amount of such Series 2007B Term Bonds that have been purchased and canceled by the City or have been optionally redeemed and which have not been made the basis for a previous reduction.

To the extent that the Series 2007B Term Bonds have been previously called for redemption or purchased and retired in part otherwise than from scheduled mandatory redemption payments, future mandatory redemption payments may be reduced by the principal amount of such Series 2007B Term Bonds so redeemed or purchased.

In lieu of mandatorily redeeming Series 2007B Term Bonds, the City has reserved the right to purchase for cancellation Series 2007B Bonds of the same maturity at a price no greater than the applicable redemption price of such Series 2007B Term Bonds.

Selection of Bonds for Redemption

The Paying Agent/Registrar will select by lot or other customary random method the specific Term Bonds (or with respect to Term Bonds having a denomination in excess of $5,000, each $5,000 portion thereof) to be redeemed by mandatory redemption. The principal amount of Term Bonds required to be redeemed on any redemption date pursuant to the foregoing mandatory redemption provisions shall be reduced, at the option of the City, by the principal amount of any Bonds of the same series having the same maturity which have been purchased or redeemed by the City as follows, at least 45 days prior to the mandatory redemption date.

Bonds may be redeemed in part only in integral multiples of $5,000. If a Bond subject to redemption is in a denomination larger than $5,000, a portion of such Bond may be redeemed, but only in integral multiples of $5,000. In selecting portions of Bonds for redemption, each Bond shall be treated as representing that number of Bonds of $5,000 denomination which is obtained by dividing the principal amount of such Bond by $5,000. Upon presentation and surrender of any Bond for redemption in part, the Paying Agent/Registrar, in accordance with the provisions of the Ordinance, shall authenticate and deliver in exchange therefor a Bond or Bonds of the same series and like maturity and interest rate in an aggregate principal amount equal to the unredeemed portion of the Bond so surrendered.

Notice of Redemption of the Bonds

At least 30 and not more than 60 days prior to the date fixed for any such redemption, a written notice of such redemption shall be given to the Registered Owners of the Bonds or portions thereof being called for redemption by sending written notice by certified mail addressed to each such Registered Owner at their address shown on the registration books of the Paying Agent/Registrar; provided, however, that so long as DTC is the securities depository for the Bonds such notice shall be given only to DTC. The failure to send, mail or receive any notice of redemption shall not affect the validity or effectiveness of the proceedings for the redemption of any Bonds. 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 such Bonds shall be redeemed, a substitute Bond having the same maturity date, bearing interest at the same rate, and in an aggregate principal amount equal to the unredeemed portion thereof, will be issued to the Registered Owner upon the surrender of the Bonds, being redeemed, all as provided for in the Ordinance.

Security for the Bonds

The Bonds are special obligations of the City that, together with the Outstanding Subordinate Lien Bonds and any Additional Subordinate Lien Bonds hereafter issued, are payable from and (subject and subordinate to the prior and superior lien of any Senior Lien Bonds) are equally and ratably secured by a lien on the Net Revenues of the Houston Airport System and the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund, all as defined and provided in the Ordinance. For definitions of certain capitalized terms used herein see APPENDIX H. See also "DEBT SERVICE REQUIREMENTS OF HOUSTON AIRPORT SYSTEM BONDS."

The Bonds do not constitute a general obligation of the City. Owners of the Bonds shall never have the right to demand payment of principal of or interest on the Bonds from any funds raised or to be raised by taxation.

Net Revenues. Net Revenues means that portion of Gross Revenues remaining after the deduction of the Operation and Maintenance Expenses of the Houston Airport System. See APPENDIX H.

Gross Revenues. Gross Revenues means all income and revenues derived directly or indirectly by the City from the operation and use of and otherwise pertaining to the Houston Airport System, or any part thereof, whether resulting from extensions, enlargements, repairs, betterments or other improvements to the Houston Airport System, or otherwise and includes, except to the extent hereinafter expressly excluded, all revenues received by the City from the Houston Airport System, including, without limitation, all rentals, rates, fees and other charges for the use of the Houston Airport System, or for any service rendered by the City in the operation thereof, interest and other income realized from the investment or deposit of amounts credited to any Houston Airport System fund, except as set forth below, required to be maintained pursuant to the Ordinance or any other ordinance authorizing the issuance of Houston Airport System Bonds. See APPENDIX H.

Gross Revenues expressly exclude: (1) proceeds of any Bonds (as defined in the Ordinance); (2) interest or other investment income derived from Bond (as defined in the Ordinance) proceeds deposited to the credit of any escrow or construction fund, or applied to fund capitalized interest, or interest or investment income required to be retained in the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund or the Operation and Maintenance Reserve Fund or any escrow fund in order to accumulate therein any amount or balance required to be accumulated or maintained therein pursuant to any ordinance authorizing any series of Houston Airport System Bonds; (3) any moneys received as grants, appropriations, or gifts, the use of which is limited by the grantor or donor to the construction or acquisition of the Houston Airport System facilities, except to the extent any such moneys shall be received as payments for the use of the Houston Airport System facilities; (4) any revenues derived from any Special Facilities which are pledged to the payment of Special Facilities Bonds; (5) insurance proceeds other than loss of use or business interruption insurance proceeds; (6) the proceeds of any passenger facility charge or other per-passenger charge as may be authorized under federal law including, but not limited to, those revenues defined as PFC Revenues; (7) sales and other taxes collected by the Houston Airport System on behalf of the State of Texas and any other taxing entities; (8) Federal Payments received by the Houston Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Houston Airport System Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes; (9) the net proceeds received by the City from the disposition of any Houston Airport System property; and (10) Excluded Fee and Charge Revenues after the Amendment Effective Date (as defined herein). See "—Amendments of Outstanding Bond Ordinances" for a description of the proposed amendment to the Gross Revenues definition that excludes from Gross Revenues the proceeds of certain future fees and charges that are defined in the Ordinance as Excluded Fee and Charge Revenues and the amendment process.

Operation and Maintenance Expenses. Operation and Maintenance Expenses means all reasonable and necessary current expenses of the City, paid or accrued, of operating, maintaining and repairing the Houston Airport System, including, without limitation, reasonably allocated City overhead expenses relating to the administration, operation and maintenance of the Houston Airport System; insurance and fidelity bond premiums; payments to pension and other funds and to any self-insurance fund not in excess of premiums which would otherwise be required for such insurance; any general and excise taxes or other governmental charges imposed by entities other than the City; costs of contractual and professional services, labor, materials and supplies for current operations, including the costs of such direct City services rendered to the Houston Airport System as are requested from the City by the Houston Airport System and as are reasonably necessary for the operation of the Houston Airport System; costs of issuance of Bonds for the Houston Airport System (except to the extent paid from the proceeds thereof); fiduciary costs; costs of collecting and refunding Gross Revenues; utility costs; any lawful refunds of any Gross Revenues; and all other administrative, general and commercial expenses. Operation and Maintenance Expenses include only those current expenses due or payable within the next 30 days.

Certain expenses are specifically excluded from the definition of Operation and Maintenance Expenses, as follows: (1) any allowance for depreciation; (2) costs of capital improvements; (3) reserves for major capital improvements, Houston Airport System operations, maintenance or repair; (4) any allowance for redemption of, or payment of interest or premium on, Houston Airport System Bonds; (5) any liabilities incurred in acquiring or improving properties of the

Houston Airport System; (6) expenses of lessees under Special Facilities Leases and operation and maintenance expenses pertaining to Special Facilities to the extent they are required to be paid by such lessees pursuant to the terms of the Special Facilities Leases; (7) any charges or obligations incurred in connection with any lawful Houston Airport System purpose, including the lease, acquisition, operation or maintenance of any facility or property benefiting the Houston Airport System, provided that the payment of such charges or obligations is expressly agreed by the payee to be payable solely from proceeds of the Airports Improvement Fund; (8) liabilities based upon the City's negligence or other ground not based on contract; and (9) so long as Federal Payments are excluded from Gross Revenues, an amount of expenses that would otherwise constitute Operation and Maintenance Expenses for such period equal to the Federal Payments for such period. See APPENDIX H.

Potential Effects of City Charter Revenue Limitations on Airport Revenues. For a discussion of the effect of certain City Charter tax and revenue limitations, voter-approved propositions, and the potential impact of ongoing litigation involving such limitations and propositions on the operation of the Houston Airport System, see "THE CITY OF HOUSTON AND CITY FINANCIAL INFORMATION—City Charter Tax and Revenue Limitations."

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Flow of Funds

Below is a presentation of the application of revenues under provisions of the Outstanding Bond Ordinances of the Houston Airport System. For more information about the Houston Airport System's revenues, see "The Bonds—Security for the Bonds" and "APPENDIX H."

Gross Revenues

Revenue Fund
Deposit all Gross Revenues

Bond Ordinance Priority	Fund
1	**Operation and Maintenance Expenses** Pay all current Operation and Maintenance Expenses
	= Net Revenues
2	**Senior Lien Bond Interest and Sinking Fund** Pay Debt Service Requirements on Senior Lien Bonds
3	**Senior Lien Bond Reserve Fund** Reestablish Senior Lien Bond Reserve Fund Requirement
4	**Subordinate Lien Bond Interest and Sinking Fund** Pay Debt Service Requirements on Subordinate Lien Bonds
5	**Subordinate Lien Bond Reserve Fund** Reestablish Subordinate Lien Bond Reserve Fund Requirement
6	**Inferior Lien Bonds** Pay debt service on Inferior Lien Bonds (if any)
7	**Operation and Maintenance Reserve Fund** Maintain reserve of two months current Operation and Maintenance Expenses
8	**Renewal and Replacement Fund** Replenish Fund to meet Renewal and Replacement Requirement
9	**Airports Improvement Fund** May be used for any lawful Houston Airport System Purpose

Debt Service Reserves

The Ordinance requires the maintenance of a Subordinate Lien Bond Reserve Fund for all Outstanding and any Additional Subordinate Lien Bonds and requires to be maintained therein a balance equal to the Reserve Fund Requirement for such Subordinate Lien Bonds. With respect to such Subordinate Lien Bonds, "Reserve Fund Requirement" means the amount required to be maintained in the Subordinate Lien Bond Reserve Fund which shall be computed and recomputed upon the issuance of each series of Subordinate Lien Bonds and on each date on which Subordinate Lien Bonds are paid at maturity or optionally or mandatorily redeemed, to be the greatest amount of Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for all Subordinate Lien Bonds then Outstanding, including any series of Subordinate Lien Bonds then being issued. Upon the issuance of the Bonds, the Reserve Fund Requirement for the Subordinate Lien Bonds shall be as set forth in the Officers Pricing Certificate.

Each increase in the Reserve Fund Requirement resulting from the issuance of Additional Subordinate Lien Bonds is also required to be funded at the time of issuance and delivery of such series of Additional Subordinate Lien Bonds. The Reserve Fund Requirement may be satisfied by depositing to the credit of the Subordinate Lien Bond Reserve Fund either (1) proceeds of such Additional Subordinate Lien Bonds or other lawfully appropriated funds in not less than the amount which, together with investment earnings thereon as estimated by the City, will be sufficient to fund fully the Reserve Fund Requirement by no later than the end of the period of time for which the payment of interest on such Additional Subordinate Lien Bonds has been provided out of proceeds of such Additional Subordinate Lien Bonds or investment earnings thereon as estimated by the City or from other lawfully available funds other than Net Revenues or (2) one or more surety bonds, insurance policies or letters of credit in a principal amount equal to the amount required to be funded, provided that the rating either for the long-term unsecured debt of the issuer of the surety bond, insurance policy or letter of credit or for obligations insured, secured or guaranteed by such issuer have a rating in one of the two highest letter categories by two of the major municipal securities evaluation services (or, if they are no longer in existence, by comparable services) and which shall be payable on demand of the City for the benefit of the Owners of the Subordinate Lien Bonds (collectively, a "Subordinate Lien Bond Reserve Fund Surety Policy").

The Ordinance further provides that in any month in which the Subordinate Lien Bond Reserve Fund contains less than the Reserve Fund Requirements for the Subordinate Lien Bonds (or so much thereof as shall then be required to be therein if the City has elected to accumulate the Reserve Fund Requirement for any series of Additional Subordinate Lien Bonds as above provided), then on or before the last business day of such month, after making all required payments and provision for payment of Operation and Maintenance Expenses, and after making all required transfers to the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund and the Subordinate Lien Bond Interest and Sinking Fund, there shall be transferred into the Subordinate Lien Bond Reserve Fund from the Revenue Fund, in equal monthly installments, amounts sufficient to enable the City to pay all reimbursement obligations under the Subordinate Lien Bond Reserve Fund Surety Policy within a 12-month period and such additional amounts as shall be sufficient to enable the City within any 12-month period to re-establish in the Subordinate Lien Bond Reserve Fund the Reserve Fund Requirement for the Subordinate Lien Bonds. After such amount has been accumulated in the Subordinate Lien Bond Reserve Fund and so long thereafter as such Fund contains such amount, no further transfers shall be required to be made into the Subordinate Lien Bond Reserve Fund, and any excess amounts in such Fund shall be transferred to the Revenue Fund. But if and whenever the balance in the Subordinate Lien Bond Reserve Fund is reduced below such amount, monthly transfers to such Fund shall be resumed and continued in such amounts as shall be required to restore the Subordinate Lien Bond Reserve Fund to such amount within any 12-month period. The Subordinate Lien Bond Reserve Fund shall be used to pay the principal of and interest on the Subordinate Lien Bonds at any time when there is not sufficient money available in the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policy), to pay reimbursements under the Subordinate Lien Bond Reserve Fund Surety Policy, and it may be used to make the final payments for the retirement or defeasance of all Subordinate Lien Bonds then Outstanding.

In order to satisfy its obligations with respect to the Reserve Fund Requirement for the Outstanding Subordinate Lien Bonds, the City previously acquired certain Subordinate Lien Bond Reserve Fund Surety Policies. In order to satisfy its obligations with respect to the Reserve Fund Requirement for the Senior Lien Commercial Paper Notes, the City previously acquired certain Senior Lien Bond Reserve Fund Surety Policies. For a discussion regarding such policies, see "RESERVE FUND SURETY POLICIES."

Additional Reserves and Other Funds

The Ordinance also provides for maintenance of an Operation and Maintenance Reserve Fund and a Renewal and Replacement Fund. The Operation and Maintenance Reserve Fund is required to be funded in an amount at least equal to two months' current Operation and Maintenance Expenses (which amount shall annually be redetermined by the Director of the Houston Airport System at the time such official submits the proposed annual Houston Airport System budget based upon either such official's recommended budget for Operation and Maintenance Expenses or estimate of actual Operation and Maintenance Expenses for the then-current Fiscal Year). The amount required by the Ordinance to be maintained in the Renewal and Replacement Fund out of surplus funds of the Houston Airport System is $10,000,000 (or any greater amount required by an ordinance authorizing any series of Additional Senior Lien Bonds or Subordinate Lien Bonds).

Rate Covenant

The City has covenanted in the Ordinance that it will at all times fix, charge, impose and collect rentals, rates, fees and other charges for use of the Houston Airport System, and, to the extent it legally may do so, revise the same as may be necessary or appropriate, in order that in each Fiscal Year the Net Revenues will at all times be at least sufficient to equal the larger of either: (1) all amounts required to be deposited in such Fiscal Year to the credit of the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund, or (2) an amount not less than 125% of the Debt Service Requirements for Senior Lien Bonds for such Fiscal Year plus 110% of the Debt Service Requirements for Subordinate Lien Bonds for such Fiscal Year. (Such covenant is referred to herein as the "Rate Covenant.")

Debt Service Requirements do not include any interest on Houston Airport System Bonds to the extent that the provision for the payment of such interest has been made by (1) appropriating for such purpose amounts sufficient to provide for the full and timely payment of such interest either from the proceeds of Houston Airport System Bonds, from interest earned or to be earned thereon, from other Houston Airport System funds other than Net Revenues, or from any combinations of such sources and (2) depositing such amounts (interest to be earned to be deposited as received) into a fund or account for capitalized interest, the proceeds of which are required to be transferred as needed into the Senior Lien Bond Interest and Sinking Fund or the Subordinate Lien Bond Interest and Sinking Fund, as the case may be. See APPENDIX H. Subject to the procedure described in "–Amendments of Outstanding Bond Ordinances," the Ordinance amends the Debt Service Requirements definition to exclude any portion or all of the interest on or principal of Houston Airport System Bonds which has been irrevocably committed to be paid from Houston Airport System funds other than Net Revenues. See "— Amendments of Outstanding Bond Ordinances."

If the Net Revenues in any Fiscal Year are less than the amounts specified above, the City, promptly upon receipt of the annual audit for such Fiscal Year, must request an Airport Management Consultant to make its recommendations, if any, as to a revision of the City's rentals, rates, fees and other charges, its Operation and Maintenance Expenses or the method of operation of the Houston Airport System in order to satisfy as quickly as practicable the foregoing requirements. Copies of such request and the recommendations of the Airport Management Consultant, if any, shall be filed with the City Secretary. So long as the City substantially complies in a timely fashion with the recommendations of the Airport Management Consultant, the City will not be deemed to have defaulted in the performance of its duties under the Ordinance even if the resulting Net Revenues are not sufficient to be in compliance with the Rate Covenant, so long as there is no other default under the Ordinance.

The City's ability to comply with the Rate Covenant may be limited in that, among other things, (1) a significant portion of the Gross Revenues of the Houston Airport System are derived pursuant to contracts which cannot be adjusted unilaterally by the City, (2) the most important contracts, Use and Lease Agreements with the airlines, provide for recovery of certain operating and capital costs attributable to facilities covered by such contracts and do not include a debt service coverage factor, (3) parking and other sources of Gross Revenues, which are not derived under contracts, are subject to competitive supply and demand constraints, and (4) certain city charter tax and revenue limitations, voter-approved propositions and ongoing litigation involving such limitations and propositions could have an impact on the operations of the Houston Airport System. See "THE CITY OF HOUSTON AND CITY FINANCIAL INFORMATION–City Charter Tax and Revenue Limitations."

Bondholders' Remedies

The Ordinance provides that if the City defaults in the payment of principal of or interest on any Subordinate Lien Bonds, including the Bonds, or the performance of any duty or covenant provided by law or in the Ordinance, Owners of such Subordinate Lien Bonds, including the Bonds, may pursue all legal remedies afforded by the Constitution and the laws of the State of Texas to compel the City to remedy such default and to prevent further default or defaults.

The Ordinance neither appoints nor makes any provision for the appointment of a trustee to protect the rights of Owners of the Bonds. Furthermore, the Ordinance does not provide for acceleration of maturity of the Bonds or for foreclosure on Net Revenues or possession of Net Revenues by a trustee or agent for Owners of the Bonds or for operation of the Houston Airport System by an independent third party in the event of default.

No lien has been placed on any of the physical properties comprising the Houston Airport System to secure the payment of or interest on the Bonds. Moreover, in the event of default, the Owners of the Bonds have no right or claim under the laws of the State of Texas against the Houston Airport System or any property of the City other than their right to receive payment from Net Revenues and certain Funds maintained pursuant to the Ordinance. Owners of the Bonds have no right to demand payment of principal of or interest or premium, if any, on the Bonds from any funds raised or to be raised by taxation or from any funds on deposit in any of the special Funds described in the Ordinance, except the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund. Accordingly, the only practical remedy in the event of a default may be a mandamus or mandatory injunction proceeding to compel the City to increase rates and charges reasonably required for the use and service of the Houston Airport System or perform its other obligations under the Ordinance, including the deposit of the Gross Revenues into the special Funds provided in the Ordinance and the application of such Gross Revenues and such special Funds in the manner required in the Ordinance. Such remedy may need to be enforced on a periodic basis because maturity of the Bonds is not subject to acceleration. In addition, the City's ability to comply with the Rate Covenant will be limited by contractual and competitive supply and demand constraints. See "–Rate Covenant."

The enforcement of a claim for payment of principal of or interest on the Bonds and the City's other obligations with respect to the Bonds are subject to the applicable provisions of the federal bankruptcy laws and to any other similar laws affecting the rights of creditors of political subdivisions generally.

Additional Houston Airport System Bonds

General Provisions. The Ordinance provides that the City has reserved the right to issue, for any lawful Houston Airport System purpose, one or more installments of Additional Senior Lien Bonds and Additional Subordinate Lien Bonds, provided that no Additional Houston Airport System Bonds may be issued unless all of the following conditions are satisfied (the "Additional Bonds Test"):

(1) The Mayor and the Director of the Houston Airport System certify that, upon the issuance of each of such series of Additional Houston Airport System Bonds, the City will not be in default under any term or provision of any Houston Airport System Bonds then Outstanding or any ordinance pursuant to which any of such Houston Airport System Bonds were issued;

(2) The City Controller certifies that, upon the issuance of each of such series of Additional Houston Airport System Bonds, the Senior Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Interest and Sinking Fund will contain the amounts required to be on deposit therein and the Senior Lien Bond Reserve Fund and the Subordinate Lien Bond Reserve Fund will contain the applicable Reserve Fund Requirement or so much thereof as is required to be funded at such time;

(3) The City Controller certifies that, for either the City's most recent complete Fiscal Year or for any consecutive 12 out of the most recent 18 months, the Net Revenues of the Houston Airport System were equal to at least (a) 125% of the Debt Service Requirements on all then-Outstanding Senior Lien Bonds for such period plus (b) 110% of the Debt Service Requirements on all then-Outstanding Subordinate Lien Bonds for such period;

(4) Either:

(a) An Airport Management Consultant provides a written report setting forth projections which indicate the estimated Net Revenues of the Houston Airport System for each of three consecutive Fiscal Years beginning in the earlier of (A) the first Fiscal Year following the estimated date of completion and initial use of all revenue-producing facilities to be financed with such series of Additional Houston Airport System Bonds, based upon a certified written estimated completion date by the consulting engineer for such facility or facilities, or (B) the first Fiscal Year in which the City will have scheduled payments of interest on or principal of the series of the Additional Houston Airport System Bonds to be issued for the payment of which provision has not been made as indicated in the report of such Airport Management Consultant from proceeds of such series of Additional Houston Airport System Bonds, investment income thereon or from other appropriated sources (other than Net Revenues) are equal to at least (i) 125% of the Debt Service Requirements on all Senior Lien Bonds plus (ii) 110% of the Debt Service Requirements on all Subordinate Lien Bonds scheduled to occur during each such respective Fiscal Year after taking into consideration the additional Debt Service Requirements for the series of Additional Houston Airport System Bonds to be issued (such projections being referred to herein as the "Future Earnings Test"); or

(b) In lieu of the certification described in (a), the City Controller may provide a certificate showing that, for either the City's most recent complete Fiscal Year or for any consecutive 12 out of the most recent 18 months, the Net Revenues of the Houston Airport System were equal to at least (i) 125% of the maximum Debt Service Requirements on all Senior Lien Bonds plus (ii) 110% of the maximum Debt Service Requirements on all Subordinate Lien Bonds scheduled to occur in the then-current or any future Fiscal Year after taking into consideration the issuance of the series of Additional Houston Airport System Bonds proposed to be issued (such certification being referred to herein as the "Historical Earnings Test");

(5) If Additional Houston Airport System Bonds are being issued for the purpose of refunding less than all of the previously issued Houston Airport System Bonds which are then Outstanding, none of the certifications described in paragraphs (3) or (4) under "General Provisions" above are required (except if Senior Lien Bonds are being issued to refund Subordinate Lien Bonds) so long as the Debt Service Requirements in any Fiscal Year after the issuance of such Additional Houston Airport System Bonds will not exceed the scheduled Debt Service Requirements in the same Fiscal Year prior to the issuance of such Additional Houston Airport System Bonds;

(6) In the ordinance authorizing the series of Additional Houston Airport System Bonds proposed to be issued, provision is made for (a) additional payments into the applicable Interest and Sinking Fund sufficient to provide for any principal and interest requirements resulting from the issuance of the series of Additional Houston Airport System Bonds including, in the event that interest on the series of Additional Houston Airport System Bonds is capitalized and/or to be paid from investment earnings, a requirement for the transfer from the capitalized interest fund or account and/or from the construction fund to the applicable Interest and Sinking Fund of amounts fully sufficient to pay interest on such series of Additional Houston Airport System Bonds during the period specified in the ordinance and (b) satisfaction of the Reserve Fund Requirement by not later than the date required by the Ordinance or any other ordinance authorizing a series of Additional Senior Lien or Subordinate Lien Bonds, as the case may be;

(7) The provisions of paragraphs (4) and (5) above shall not apply to the issuance of Additional Senior or Subordinate Lien Bonds for the purpose of refunding Short Term/Demand Obligations such as the Refunded Notes; and

(8) The provisions of paragraphs (3) and (4) above shall not apply to the issuance of Completion Bonds in accordance with the Ordinance.

(9) The City may enter into Credit Agreements with respect to any Houston Airport System Bonds or Qualified Hedge Agreements if (a) prior to entering into such Credit Agreement, the City, to the extent required by law, shall cause the proceedings authorizing the Credit Agreement and any contracts or reimbursement agreements relating thereto to be submitted to and approved by the Attorney General of Texas; and (b) for any Credit Agreement that obligates the City to make any future payments for the availability of such Credit Agreement, the City's financial advisor for the Houston Airport System must certify that the inclusion of such payments within the Debt Service Requirements on the Houston Airport System Bonds or Qualified Hedge Agreement to which the Credit Agreement relates will not cause such Houston Airport System Bonds or Qualified Hedge Agreement to fail to comply with the applicable coverage requirements for their issuance or incurrence. The issuer of any Credit Agreement shall be entitled to be subrogated to the rights of the Owners of the Houston Airport System Bonds or the counterparty to the Qualified Hedge Agreement secured by such Credit Agreement, and the City's reimbursement and repayment obligations to the issuer of the Credit Agreement shall be secured by Net Revenues as provided in the Ordinance.

(10) The City may enter into Qualified Hedge Agreements contemporaneously with or following the issuance of any Houston Airport System Bonds or in conjunction with the payment, sale, resale or exchange of any Houston Airport System Bonds for any purpose authorized by law if (a) the proceedings authorizing the Qualified Hedge Agreement and any contracts or reimbursement agreements relating thereto shall, to the extent required by law, be submitted to and approved by the Attorney General of Texas; (b) the City shall have received written confirmation from each rating agency then rating the Houston Airport System Bonds that entering into such Qualified Hedge Agreement will not, in and of itself, result in a withdrawal or reduction of any rating assigned to the Houston Airport System Bonds; and (c) the City's financial advisor for the Houston Airport System shall certify that the Houston Airport System Bonds to which the Qualified Hedge Agreement relates could have been issued in satisfaction of all the applicable coverage requirements contained in the Ordinance if the Debt Service Requirements with respect to such Houston Airport System Bonds are recalculated (as provided in the definition of Debt Service Requirements) to take into account payments due under the Qualified Hedge Agreement.

See the definition of Debt Service Requirement in "Appendix H - THE ORDINANCE–SUMMARY AND DEFINITIONS."

Special Provisions for Short Term/Demand Obligations. In the Ordinance, the City has reserved the right to issue, from time to time, one or more series of Additional Senior Lien Bonds and/or Additional Subordinate Lien Bonds as Short Term/Demand Obligations, provided that the aggregate principal amount of Short Term/Demand Obligations Outstanding at any time may not exceed the greater of $150,000,000 or 30% of the aggregate principal amount of Houston Airport System Bonds Outstanding at the time of issuance of the last series of Short Term/Demand Obligations, and further provided that the other conditions for issuing Additional Houston Airport System Bonds are met. In addition, no Short Term/Demand Obligation shall be subject to the limitations as to maximum principal amount as set forth above during any period of time that the City's financial advisor for the Houston Airport System certifies that the City's variable or adjustable interest rate exposure under such Short Term/Demand Obligation is substantially hedged pursuant to an interest rate swap, interest rate cap or other interest rate hedging mechanism with a counterparty having a rating in one of the two highest credit rating categories by at least two major rating agencies pursuant to which the maximum net rate of interest that the City is obligated to pay (after taking into account all payments to be made by such counterparty) does not exceed the interest rate certified with respect to such Short Term/Demand Obligation by such financial advisor pursuant to paragraph (b) clause (i) of the definition of Debt Service Requirements. See definition of "Debt Service Requirement" in APPENDIX H.

Special Provisions for Completion Bonds. The City has also reserved the right in the Ordinance to issue one or more series of Houston Airport System Bonds to pay the cost of completing any Project (as defined in the following paragraph) for which Houston Airport System Bonds have been previously issued. Prior to the issuance of any series of Completion Bonds the City must provide, in addition to all of the applicable certificates required in "General Provisions" above, (1) a certificate from the consulting engineer engaged by the City to design the Project for which the Completion Bonds are to be issued stating that such Project has not materially changed in scope since the issuance of the most recent series of Senior Lien Bonds or Subordinate Lien Bonds for such purpose (except as permitted in the applicable ordinance authorizing such Senior Lien Bonds or Subordinate Lien Bonds) and setting forth the aggregate cost of the Project which, in the opinion of such consulting engineer, has been or will be incurred; and (2) a certificate of the Director of the Houston Airport System (a) stating that all amounts allocated to pay the costs of the Project from the proceeds of the most recent series of Houston Airport System Bonds issued in connection with the Project for which the Completion Bonds are being issued were used or are still available to be used to pay costs of such Project, (b) containing a calculation of the amount by which the aggregate cost of that Project (furnished in the consulting engineer's certificate described above) exceeds the sum of the costs of the Project paid to such date plus the moneys available at such date within any construction fund established therefor or other-like account applicable to the Project plus any other moneys which the Director of the Houston Airport System, in his discretion, has determined are available to pay such costs in any other fund, and (c) certifying that, in the opinion of the Director of the Houston Airport System, the issuance of the Completion Bonds is necessary to provide funds for the completion of the Project.

For purposes of the provisions for Completion Bonds, the term "Project" shall mean any Houston Airport System facility or project which shall be defined as a Project in any ordinance authorizing the issuance of Additional Houston Airport System Bonds for the purpose of financing such Project. Any such ordinance may contain such further provisions as the City shall deem appropriate with regard to the use, completion, modification or abandonment of such Project.

Exception for Special Facilities Bonds. In the Ordinance, the City has also reserved the right to issue, from time to time, in one or more series, Special Facilities Bonds to finance and refinance the cost of any Special Facilities, including all reserves required therefor, all related costs of issuance and other amounts reasonably relating thereto, provided that such Special Facilities Bonds shall be payable solely from payments by Special Facilities lessees and/or other security not provided by the City. In no event shall any Gross Revenues or any other amounts held in any other Fund or account maintained by the City as security for the Bonds or for the construction, operation, maintenance or repair of the Houston Airport System be pledged to the payment of Special Facilities Bonds or to the payment of any expenses of maintenance and operation of Special Facilities. The Special Facilities Bonds shall include all those outstanding as of the date of enactment of the Ordinance.

Exception for Inferior Lien Obligations. The City has also reserved the right in the Ordinance to issue or incur, for any lawful Houston Airport System purpose, bonds, notes or other obligations, secured in whole or in part by liens on the Net Revenues that are junior and subordinate to the lien on Net Revenues securing payment of the Senior Lien Bonds and the Subordinate Lien Bonds. Such inferior lien bonds, notes or other obligations may be further secured by any other source of payment lawfully available for such purposes.

Exception for PFC Obligations. The City has reserved the right to issue or incur for any lawful Houston Airport System purpose bonds, notes, or other obligations secured in whole or in part by a lien on all or any designated portion of the PFC Revenues. Such PFC Obligations may be further secured by any other source of payment lawfully available for such purpose. For a discussion of the treatment of PFC Revenues under the Ordinance, see "APPENDIX H."

Exception for Excluded Fee and Charge Revenues Obligations. The City has reserved the right to issue or incur for any lawful Houston Airport System purpose bonds, notes or other obligations secured in whole or in part by a lien on all or any designated portion of the Excluded Fee and Charge Revenues. Such obligations may be further secured by any other source of payment lawfully available for such purposes.

For a discussion of proposed additional Houston Airport System financings, see "THE HOUSTON AIRPORT SYSTEM–Houston Capital Improvement Program" and "ADDITIONAL FINANCING."

Amendments of Outstanding Bond Ordinances

Ordinance Amendments. Under the Ordinance the City has determined to amend certain provisions, including the definitions of "Debt Service Requirements" and "Gross Revenues." The definition of Debt Service Requirements is being amended in order to recognize that Debt Service Requirements (to the payment of which Net Revenues are pledged) may be reduced to the extent moneys are made available from sources (e.g. PFC Revenues) from funds other than Net Revenues. The definition of Gross Revenues is being amended to exclude Excluded Fee and Charge Revenues (such amendments are collectively herein referred to herein as the "Amendments"). In addition to the Amendments, the Ordinance contains additional provisions to allow for the implementation of revised definitions of Gross Revenues and Debt Service Requirements, and clarifies the treatment of PFC Revenues under the existing Ordinance. For a description of the Amendments and other additional changes to the Ordinance, see "APPENDIX H – The Ordinance – Summary and Glossary of Terms – Summary of Selected Provisions."

The Amendments. The Ordinance provides that the Amendments are being adopted as part of the Ordinance, and shall be binding upon all Owners, from time to time, of the Bonds. Additionally, the City expects that to include the Amendments in each ordinance authorizing Additional Bonds. The City has authorized the amendment of each of its previously adopted ordinances pursuant to which bonds are outstanding to include the Amendments, subject, however, in each case to obtaining written consent from appropriate party or parties required or authorized to grant such consent to the inclusion of the Amendments pursuant to the respective terms of each such prior ordinance or otherwise as may be provided in each such ordinance.

Amendment Effective Date. The Amendments shall become effective on the date on which they have become incorporated into every ordinance pursuant to which bonds are then Outstanding (the "Amendment Effective Date"). With regard to the Bonds, the Owners of the Bonds are deemed to have consented to the Amendments as set forth in the Ordinance. The Amendment Effective Date will not occur prior to the satisfaction of certain conditions for each series of Houston Airport System Bonds Outstanding. For a description of the conditions precedent to the Amendment Effective Date, see "APPENDIX H – The Ordinance – Summary and Glossary of Terms – Summary of Selected Provisions."

Amendments

The Ordinance provides that it may be amended either with or without the consent of bondholders under certain circumstances.

Amendments of Ordinance without Consent. The City may without the consent of or notice to the Owners of the Subordinate Lien Bonds amend the Ordinance for any one or more of the following purposes: (1) to cure any ambiguity, defect, omission or inconsistent provision of the Ordinance or the Subordinate Lien Bonds or to comply with any applicable provision of law or regulation; provided, however, that such action shall not adversely affect the interests of the Owners of the Subordinate Lien Bonds; (2) to change the terms or provisions of the Ordinance to the extent necessary to prevent the interest on the Subordinate Lien Bonds from being includable within the gross income of the Owners thereof for federal income tax purposes; (3) to grant to or confer upon the Owners of the Subordinate Lien Bonds any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Owners of the Subordinate Lien Bonds; (4) to add to the covenants and agreements of the City contained in the Ordinance other than covenants and agreements of, or conditions or restrictions upon, the City or to surrender or eliminate any right or power reserved to or conferred upon the City in the Ordinance; or (5) to subject to the lien and pledge of the Ordinance additional Net Revenues which may include revenues, properties or other collateral.

Amendments of Ordinance with Consent. The City may at any time adopt one or more ordinances amending, modifying, adding to or eliminating any provisions of the Ordinance, but, if such amendment is not of the character described in the preceding paragraph, only with the consent given in accordance with the Ordinance of the Owner or Owners of not less than a majority in aggregate unpaid principal amount of the Subordinate Lien Bonds then Outstanding and affected by such amendment, modification, addition or elimination; provided, however, no such amendment, modification, addition or elimination shall permit (1) an extension of the maturity of the principal of or interest on any Subordinate Lien Bond issued under the Ordinance, (2) a reduction in the principal amount of any Subordinate Lien Bond or the rate of interest on any Subordinate Lien Bond, (3) a privilege or priority of any Subordinate Lien Bond or Subordinate Lien Bonds over any other Subordinate Lien Bond or Subordinate Lien Bonds, or (4) a reduction in the aggregate principal amount of the Subordinate Lien Bonds required for consent to such amendment, unless the Owner or Owners of 100% in aggregate principal amount of the Subordinate Lien Bonds shall consent to any of such changes.

Bond Insurer Deemed Owner. For purposes of giving any consent as provided in the preceding paragraph (except under (1), (2), (3), and (4) thereof) the Bond Insurer shall be deemed to be the Owner of the Bonds secured by the Bond Insurance Policy issued by such Bond Insurer.

BOND INSURANCE

Financial Guaranty Insurance Company ("Financial Guaranty") has supplied the following information for inclusion in this Official Statement. No representation is made by the issuer or the underwriter as to the accuracy or completeness of this information.

Payments Under the Policy

Concurrently with the issuance of the Bonds, Financial Guaranty Insurance Company ("Financial Guaranty") will issue its Municipal Bond New Issue Insurance Policy for the Bonds (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal or accreted value (if applicable) of and interest on the Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the issuer of the Bonds (the "Issuer"). Financial Guaranty will make such payments to U.S. Bank Trust National Association, or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal, accreted value or interest (as applicable) is due or on the business day next following the day on which Financial Guaranty shall have received notice (in accordance with the terms of the Policy) from an owner of Bonds or the trustee or paying agent (if any) of the nonpayment of such amount by the Issuer. The Fiscal Agent will disburse such amount due on any Bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal, accreted value or interest (as applicable) due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal, accreted value or interest (as applicable) shall be vested in Financial Guaranty. The term "nonpayment" in respect of a Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

Once issued, the Policy is non-cancellable by Financial Guaranty. The Policy covers failure to pay principal (or accreted value, if applicable) of the Bonds on their stated maturity dates and their mandatory sinking fund redemption dates, and not on any other date on which the Bonds may have been otherwise called for redemption, accelerated or advanced in maturity. The Policy also covers the failure to pay interest on the stated date for its payment. In the event that payment of the Bonds is accelerated, Financial Guaranty will only be obligated to pay principal (or accreted value, if applicable) and interest in the originally scheduled amounts on the originally scheduled payment dates. Upon such payment, Financial Guaranty will become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and will be fully subrogated to all of the Bondholder's rights thereunder.

The Policy does not insure any risk other than Nonpayment by the Issuer, as defined in the Policy. Specifically, the Policy does not cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity; (ii) payment of any redemption, prepayment or acceleration premium; or (iii) nonpayment of principal (or accreted value, if applicable) or interest caused by the insolvency or negligence or any other act or omission of the trustee or paying agent, if any.

As a condition of its commitment to insure Bonds, Financial Guaranty may be granted certain rights under the Bond documentation. The specific rights, if any, granted to Financial Guaranty in connection with its insurance of the Bonds may be set forth in the description of the principal legal documents appearing elsewhere in this Official Statement, and reference should be made thereto.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

In the event that Financial Guaranty is unable to fulfill its obligations under the Policy, the policy holder or bondholder is not protected by an insurance guaranty fund or other solvency protection arrangement.

Financial Guaranty Insurance Company

Financial Guaranty is a New York stock insurance corporation that writes financial guaranty insurance in respect of public finance and structured finance obligations and other financial obligations, including credit default swaps. Financial Guaranty is licensed to engage in the financial guaranty insurance business in all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands and the United Kingdom.

Financial Guaranty is a direct, wholly owned subsidiary of FGIC Corporation, a Delaware corporation. At June 30, 2007, the principal owners of FGIC Corporation and the approximate percentage of its outstanding common stock owned by each were as follows: The PMI Group, Inc. – 42%; affiliates of the Blackstone Group L.P. – 23%; and affiliates of the Cypress Group L.L.C. – 23%. Neither FGIC Corporation nor any of its stockholders or affiliates is obligated to pay any debts of Financial Guaranty or any claims under any insurance policy, including the Policy, issued by Financial Guaranty.

Financial Guaranty is subject to the insurance laws and regulations of the State of New York, where Financial Guaranty is domiciled, including New York's comprehensive financial guaranty insurance law. That law, among other things, limits the business of each financial guaranty insurer to financial guaranty insurance (and related lines); requires that each financial guaranty insurer maintain a minimum surplus to policyholders; establishes limits on the aggregate net amount of exposure that may be retained in respect of a particular issuer or revenue source (known as single risk limits) and on the aggregate net amount of exposure that may be retained in respect of particular types of risk as compared to the policyholders' surplus (known as aggregate risk limits); and establishes contingency, loss and unearned premium reserve requirements. In addition, Financial Guaranty is also subject to the applicable insurance laws and regulations of all other jurisdictions in which it is licensed to transact insurance business. The insurance laws and regulations, as well as the level of supervisory authority that may be exercised by the various insurance regulators, vary by jurisdiction.

At June 30, 2007, Financial Guaranty had net admitted assets of approximately \$4.040 billion, total liabilities of approximately \$2.944 billion, and total capital and policyholders' surplus of approximately \$1.096 billion, determined in accordance with statutory accounting practices ("SAP") prescribed or permitted by insurance regulatory authorities.

The unaudited financial statements as of June 30, 2007, and the audited consolidated financial statements of Financial Guaranty and subsidiaries, on the basis of U.S. generally accepted accounting principles ("GAAP"), as of December 31, 2006 and December 31, 2005, which will be filed with the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"), are hereby included by specific reference in this Official Statement. Any statement contained herein under the heading "BOND INSURANCE," or in any documents included by specific reference herein, shall be modified or superseded to the extent required by any statement in any document subsequently filed by Financial Guaranty with such NRMSIRs, and shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement. All financial statements of Financial Guaranty (if any) included in documents filed by Financial Guaranty with the NRMSIRs subsequent to the date of this Official Statement and prior to the termination of the offering of the Bonds shall be deemed to be included by specific reference into this Official Statement and to be a part hereof from the respective dates of filing of such documents.

The New York State Insurance Department recognizes only SAP for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under the New York Insurance Law, and for determining whether its financial condition warrants the payment of a dividend to its stockholders. Although Financial Guaranty prepares both GAAP and SAP financial statements, no consideration is given by the New York State Insurance Department to financial statements prepared in accordance with GAAP in making such determinations. A discussion of the principal differences between SAP and GAAP is contained in the notes to Financial Guaranty's audited SAP financial statements.

Copies of Financial Guaranty's most recently published GAAP and SAP financial statements are available upon request to: Financial Guaranty Insurance Company, 125 Park Avenue, New York, NY 10017, Attention: Corporate Communications Department. Financial Guaranty's telephone number is (212) 312-3000.

Financial Guaranty's Credit Ratings

The financial strength of Financial Guaranty is rated "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc., "Aaa" by Moody's Investors Service, and "AAA" by Fitch Ratings. Each rating of Financial Guaranty should be evaluated independently. The ratings reflect the respective ratings agencies' current assessments of the insurance financial strength of Financial Guaranty. Any further explanation of any rating may be obtained only from the applicable rating agency. These ratings are not recommendations to buy, sell or hold the Bonds, and are subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Bonds. Financial Guaranty does not guarantee the market price or investment value of the Bonds nor does it guarantee that the ratings on the Bonds will not be revised or withdrawn.

Neither Financial Guaranty nor any of its affiliates accepts any responsibility for the accuracy or completeness of the Official Statement or any information or disclosure that is provided to potential purchasers of the Bonds, or omitted from such disclosure, other than with respect to the accuracy of information with respect to Financial Guaranty or the Policy under the heading "BOND INSURANCE." In addition, Financial Guaranty makes no representation regarding the Bonds or the advisability of investing in the Bonds.

RESERVE FUND SURETY POLICIES

General

In order to satisfy its obligations with respect to the Reserve Fund Requirement for the Outstanding Subordinate Lien Bonds, the City previously acquired Subordinate Lien Bond Reserve Fund Surety Policies issued by (1) Financial Guaranty Insurance Company ("FGIC") in the aggregate maximum amount of $105,291,488.70, (2) Financial Security Assurance ("FSA") in the aggregate maximum amount of $31,921,383.50, and (3) XL Capital Assurance, Inc. ("XLCA") in the aggregate maximum amount of $15,756,228.00. Such amounts in the aggregate equal the maximum annual principal and interest requirements for the Fiscal Year in which the requirements are greatest ("Maximum Annual Principal and Interest Requirements") on all Outstanding Subordinate Lien Bonds. The Maximum Annual Principal and Interest Requirement may be reduced by any reduction in the amount of Outstanding Subordinate Lien Bonds, or increased as the result of issuance of any Additional Subordinate Lien Bonds. The Subordinate Lien Bond Reserve Fund Surety Policies terminate on various dates in the future, beginning July 1, 2017. In the event that the City does not obtain a new Subordinate Lien Bond Reserve Fund Surety Policy or Policies by such termination dates, the City will be required to provide for any resulting deficiency in the Subordinate Lien Bond Reserve Fund by making monthly transfers to such fund, as described above. See "SECURITY FOR THE BONDS–Reserves."

After the expected issuance of the 2007A Bonds, there will be no outstanding senior lien commercial paper notes. When the City issues additional senior lien commercial paper notes, the City will be required to maintain a balance in the Senior Lien Bond Reserve Fund equal to the Reserve Fund Requirement of Senior Lien Bonds. The City presently has three outstanding Senior Lien Bond Reserve Fund Surety Policies issued by FGIC in an aggregate maximum amount of approximately $12,374,996. The Senior Lien Bond Reserve Fund Surety Policies terminate on various dates beginning October 25, 2023.

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Bond Reserve Fund Surety Policies

Upon the delivery of the Bonds, the aggregate Reserve Fund Requirement for the Outstanding Subordinate Lien Bonds will be $155,792,342. In order to satisfy its additional Reserve Fund Requirement obligations with respect to the Subordinate Lien Bond Reserve Fund and in accordance with the Officers Pricing Certificate, the City expects to acquire one or more additional Subordinate Lien Bond Reserve Fund Surety Policies from FGIC in the aggregate amount of $3,152,880 which, together with the existing Subordinate Lien Bond Reserve Fund Surety Policies, and any amounts currently on deposit in the Subordinate Lien Bond Reserve Fund, will be sufficient to satisfy the above Reserve Fund Requirement for the Subordinate Lien Bond Reserve Fund. The following table identifies outstanding Subordinate Reserve Fund Policies issued in prior City of Houston Airport System financings, plus the expected issuance of an additional Subordinate Lien Reserve Fund Surety Policy funded by the Series 2007B Bonds.

Outstanding and Expected Subordinate Lien Debt Service Reserve Fund Policies

Reserve Fund Policy Issuer	Termination Date	Maximum Amount
Financial Guaranty Insurance Company (FGIC)	July 1, 2022	$24,477,885.00
	July 1, 2017	$5,494,503.70
	July 1, 2028	$32,050,000.00
	July 1, 2030	$43,269,100.00
	July 1, 2032	$3,152,880.00*
Financial Security Assurance (FSA)	Earlier of July 1, 2032 or the date the Series 2002A and 2002B Bonds are no longer outstanding	$31,921,383.50
XL Capital Assurance Inc. (XL)	Earlier of July 1, 2032 or the date the Series 2002C, 2002D-1, and 2002D-2 Bonds are no longer outstanding	$15,756,228.00
TOTAL COVERAGE OF ALL OUTSTANDING POLICIES AND SERIES 2007B BOND FUNDED POLICY: $156,121,980.20		

* To be issued at the closing of the Series 2007B Bonds.

THE HOUSTON AIRPORT SYSTEM

The Houston Airport System

The Houston Airport System includes Intercontinental, Hobby, and Ellington, each of which is subject to all applicable provisions of the Federal Aviation Administration ("FAA") regulations pertaining to operational safety of air carrier airports. The City manages and operates the Houston Airport System as an enterprise system of the City. Existing Houston Airport System facilities are expected to be improved and expanded from time to time as demand and other factors require. See "–Houston Airport System Capital Improvement Program."

Intercontinental, which opened in 1969, is the City's dominant air carrier facility and is located approximately 22 miles north of the City's downtown on approximately 10,000 acres. Hobby is located approximately seven miles southeast of downtown on approximately 1,500 acres. Ellington is situated approximately 15 miles southeast of downtown on approximately 2,000 acres, a portion of which was conveyed to the City by the federal government on July 1, 1984.

The FAA classifies the City as a large air traffic hub. According to ACI-NA, an airport industry group, Intercontinental and Hobby ranked 8th and 42nd, respectively, based on total U.S. passenger traffic for calendar year 2006. The Houston Airport System's total passengers increased by 6.4% from 46.7 million in Fiscal Year 2005 to 49.7 million in Fiscal Year 2006. Total passengers at Intercontinental increased 7.3% from 38.4 million to 41.2 million and at Hobby increased 2.1% from 8.2 million to 8.4 million. During the first nine months of Fiscal Year 2007, total passengers increased 5.0% at Intercontinental and 2.0% at Hobby over the same period of Fiscal Year 2006. Continental is the dominant air carrier operating at Intercontinental and Southwest is the dominant air carrier operating at Hobby. See "Schedule 1–Passenger Statistics." and "Schedule 2 — Airline Market Shares."

Airport Service Region

The Houston Airport System is located in the nation's fourth most populous city and lies within the sixth largest metropolitan statistical area in the United States. Located on the coastal plain in Southeast Texas, approximately 50 miles from the Gulf of Mexico, the City is a center for the energy, financial, medical, transportation, retail and manufacturing industries.

The development and diversity of the economic base of an airport service region is important to airline traffic growth at the airports in the region. This is particularly true for an economy in which the industries in the region may rely on the airports for passenger and cargo airline service. The primary service region for the Houston Airport System, the 10-county Houston-Sugar Land-Baytown, Texas Metropolitan Statistical Area ("MSA"), has a diverse economic base and is recognized as a major national and international energy, financial, medical, transportation, retail, and distribution center. The MSA extends out two additional counties for the broader Houston-Baytown-Huntsville Combined Statistical Area ("CSA"). According to U.S. Bureau of the Census, the population estimate was 5.54 million for the MSA and 5.64 million for the CSA as of July 1, 2006. The air service region also encompasses other smaller markets such as Beaumont/Port Arthur, Victoria, Brownsville and Del Rio in Texas and Lake Charles, Louisiana as those airports only provide air service to and from Intercontinental. See the following map of the Houston Airport System Air Service Area.

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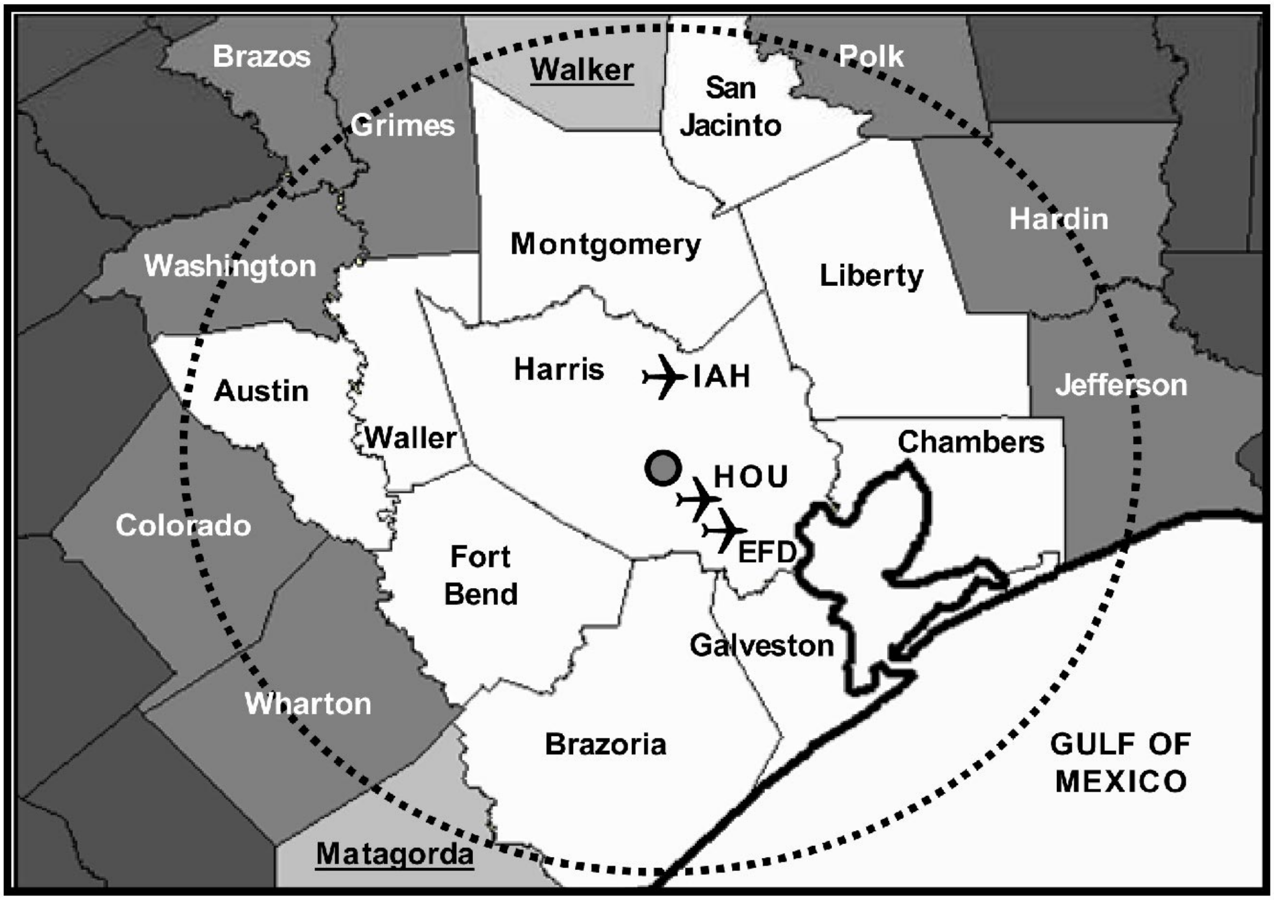
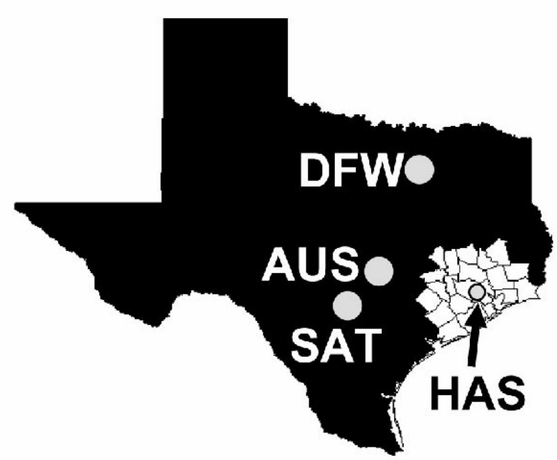
Houston Airport System Air Service Area



	Metropolitan Statistical Area (MSA) of **Houston – Sugar Land – Baytown, TX** includes 10 counties
	Consolidated Statistical Area (MSA) of **Houston – Baytown – Huntsville, TX** adds both Matagorda & Walker counties
	75-mile radius adds parts of an additional 8 counties



Source: U.S. Census Bureau

Houston Airport System Facilities

Intercontinental. Existing principal facilities at Intercontinental consist of five runways, various taxiways, aircraft aprons, a bulk fuel storage facility, an underground fuel distribution system, five terminal buildings with related support facilities, a central federal inspection services building ("Central FIS"), an automated people mover system ("APM"), a 565 guest-room hotel leased to and managed by Marriott Hotels, roadways and surface and structural parking spaces for approximately 23,624 automobiles. Intercontinental has a 12,000-foot runway, two 10,000-foot runways, a 9,400-foot runway and a 9,000-foot runway; together they are capable of handling any aircraft now in commercial service. The five terminal buildings, Terminals A, B, C, D and E (constructed by Continental Airlines), serve both narrowbody and widebody aircraft. Terminal A contains approximately 630,000 square feet of floor space and 20 aircraft gates and space for up to six turbo-prop aircraft, Terminal B has approximately 345,000 square feet of floor space and 35 aircraft gates with ramp space for up to 15 regional jet aircraft, and Terminal C has approximately 1,055,000 square feet of floor space and 31 aircraft gates. Terminal D has approximately 486,000 square feet of floor space (including the former FIS space which is not yet being used for other purposes) and 14 aircraft gates with ramp space for up to six wide-body jet aircraft which are used primarily for international arrivals and departures. Terminal E, which was financed through a special facility revenue bond with Continental, has approximately 610,000 square feet of floor space and 23 aircraft gates. The Central FIS, which was completed in January 2005, has approximately 863,000 square feet of floor space, with a capacity to process 4,000 passengers per hour based on current FIS criteria, and includes approximately 56,000 square feet for Continental's central ticketing area. Terminal D, Terminal E, the Central Ticketing Facility and the Central FIS are collectively referred to as the International Terminal Complex or "ITC." The APM stations contain approximately 83,000 square feet at Terminals B, C and the ITC.

The existing terminals and the hotel are connected by an underground train which has been in operation since the opening of Intercontinental in 1969 and has not had a major renovation. Management of the Houston Airport System is evaluating replacement options. The City and Continental have undertaken certain expansion and improvement activities at Intercontinental, including Continental's construction of a new 2,200-foot above-ground APM, or TerminaLink, system, which became available for use by Continental passengers in transit between Terminals B and C in 1999. An extension of the APM system was completed by the City in January 2005 connecting passengers between Terminals B, C, D, E and the Central FIS. The APM system is located in the secure area of Intercontinental and can only be accessed by ticketed passengers.

The Marriott Hotel at Intercontinental opened in 1972 and was expanded to 565 guest-rooms in 1982. It is owned by the City, subject to leases that terminate in 2019. Other City-owned facilities at Intercontinental include three cargo buildings and an office building occupied by Houston Airport System. Two air carriers, two fixed base operators and a number of private corporations maintain hangar and maintenance facilities and air cargo office and warehouse facilities at Intercontinental.

A consolidated rental car facility located on a site adjacent to J. F. Kennedy Boulevard opened in August 2003. The facility was financed with the proceeds of the Series 2001 Special Facility Bonds (Consolidated Rental Car Facility), which are secured by and payable from a customer facility charge assessed on rental car customers at Intercontinental. See "HOUSTON AIRPORT SYSTEM AGREEMENTS–Other Agreements."

A new cargo area complex opened in January 2003 as part of the implementation of a phased development of 165 acres of land at the northeast end of Intercontinental. See "HOUSTON AIRPORT SYSTEM AGREEMENTS–Other Agreements."

Hobby. Since 1998, Hobby is undergoing significant renovation in connection with the implementation of the capital improvement program ("CIP"). Existing principal facilities at Hobby consist of four runways, various taxiways, aircraft aprons, an underground fuel distribution system, one terminal building with a single concourse, roadways and surface and structural parking spaces for approximately 4,060 automobiles. Additional facilities include a cargo building, an office building primarily occupied by the FAA and several hangars. Hobby has two 7,600-foot runways, one 6,000-foot runway and one 5,150-foot runway and is designed to handle only narrow-body aircraft no larger than a Boeing 727-200 or an Airbus A-320. Hobby is extensively utilized for general aviation operations and is equipped to accommodate aircraft, fixed base operators and corporate hangars. Hobby currently has 21 gates available for use.

The Hobby renovation project is partially complete. The construction of the Central Concourse, including the extension to provide 24 to 25 gates is complete and all carriers are now located on it and the other concourses are being demolished. However, some gates cannot be used until the new apron work is completed. The renovation of the terminal building is the next phase. See "–Houston Airport System Capital Improvement Program."

Ellington. City facilities at Ellington include one 9,000 foot runway, one 8,000 foot runway, and one 4,600 foot runway, a fuel storage system and various buildings and hangars. The federal government has retained title to certain properties adjacent to the flight line of the former Ellington Air Force Base for federal agency use, and the City and the federal government have entered into agreements under which Ellington is being operated for joint military/civil aviation use. It is currently intended that non-governmental use of Ellington will be primarily to accommodate general aviation, relieving Hobby of such traffic. Presently, Ellington has two fixed base operators ("FBOs"), each with new hangars. There are two corporate based operators. There is one FAR Part 135 flight charter company that has signed a lease but has not started its improvements. There are currently competing parties interested in developing t-hangars along Taxilane K, which opened in mid-April of 2007. The ultimate scope and financial implications of possible future development of Ellington cannot be predicted at the current time.

Houston Airport System Capital Improvement Program

General Discussion. The City, through the Houston Airport System, has been undertaking a major CIP that began in Fiscal Year 1999 to expand and modernize Houston Airport System facilities at Intercontinental, Hobby, and Ellington. The CIP is a comprehensive plan that determines the capital and infrastructure needs of the Houston Airport System. Over the last nine years, which included Fiscal Year 1999 through Fiscal Year 2007, the program cost approximately $2.8 billion. The majority of the work, which included such major projects as a new runway and other runway and taxiway expansion and improvements, a new international arrival facility, terminal and apron improvements at Intercontinental; runway and taxiway improvements and a new concourse at Hobby; and airfield improvements at Ellington, is substantially complete or near completion, except for the final work on the central concourse at Hobby.

Projects for the proposed six-year CIP for Fiscal Years 2008 through 2013 ("FY 2008-2013 CIP") total approximately $1.90 billion. The major projects, excluding the Master Plan elements discussed below, include approximately $92 million for the Hobby terminal renovation project, including $22 million for land acquisition at Hobby, $127 million for additional renovation and improvements to terminal facilities at Intercontinental, including systems to connect passengers between terminals, $167 million for in-line baggage security systems at Intercontinental, $110 million for an APM expansion to Terminal A, $152 million for airfield projects at Intercontinental, Hobby, and Ellington, $26 million for central plant expansion at Intercontinental, $12 million for landside improvements at Intercontinental, $31 million for geographic information system development for the system, and $178 million for other facilities at Intercontinental and Hobby to maintain the facilities.

The FY 2008-2013 CIP is funded with approximately $316 million from the Airports Improvement Fund, $175 million from commercial paper and bond proceeds, approximately $675 million from future bonds for Master Plan projects and the APM, approximately $581 million may be funded, if funds become available, from either Transportation Security Administration funding for future Electronic Detection System (EDS) projects or PFC funding if application is made and approved, for certain projects at Intercontinental and additional projects at Hobby. Additionally, $150 million of projected future FAA Airport Improvement Program funding for the FY 2008-2013 CIP includes approximately $46.8 million of grant funds associated with a 10-year Letter of Intent ("LOI") from the FAA which began in Federal Fiscal Year 2001. Such LOI grant funds are expected to reduce the amount of Net Revenues required to pay Debt Service Requirements on Outstanding Airport Bonds.

The Houston Airport System is exploring with Continental Airlines a substantial renovation and expansion of Terminal B estimated to cost between $300 million and $600 million. The full scope, cost, and funding is not yet clearly defined. Approximately $325 million is included in the Intercontinental Master Plan projects below, related to renovation of Terminal B, and is included in the FY 2008-2013 CIP financing described above. The City and Continental are also exploring other alternative financing options, such as special facilities bonds.

The Houston Airport System is considering certain modifications in the FY 2008-2013 CIP. In lieu of the planned $26 million expansion of the central heating and cooling plant at Intercontinental described above, the Houston Airport System is exploring a privatized redevelopment and operation of that facility which could include a cogeneration facility to provide a backup supply of electric power for a portion of Intercontinental's needs. If approved, such project could be financed with special facilities bonds.

Master Plans. The Houston Airport System completed the Ellington Master Plan in 2002, the Hobby Master Plan in 2003 and the Intercontinental Master Plan in February 2007. Houston Airport System master plans are demand driven, not time driven. Planning Activity Levels (PAL's) are tied to growth metrics and trigger project implementation when a pre-defined level is reached. If the growth metrics indicate slow growth, then PAL's move later on the time line. Conversely, if growth metrics show rapid growth, then PAL's move closer on the time line and warrant a faster response.

The implementation portion of the Hobby Master Plan identified $1 billion in improvements that should be made to the airport by 2023. Some of these projects are in the FY 2008-2013 CIP. Other projects will be added from the master plan to the upcoming CIP. Actual implementation of those projects will depend on the outcome of an Environmental Impact Study (EIS). The EIS will determine which set of alternative projects to pursue.

The implementation portion of the Intercontinental Master Plan identified $6.25 billion in improvements that should be made to the airport by 2025. Approximately $1 billion in planned projects has been proposed in the FY 2008-2013 CIP. When the Intercontinental EIS is completed, an additional $5 billion will be programmed into the CIP over the next 15 years.

Passenger Facility Charge (PFC). The City is also authorized to impose PFCs for certain Houston Airport System improvements, subject to approval by the U.S. Department of Transportation. On November 1, 2006, the City implemented a PFC of $3.00 per enplaned passenger at Hobby. The City has authority to impose and use $163,415,047. The City's authority to impose and use PFCs at Hobby is subject to certain terms and conditions provided in the federal PFC authorizing legislation, the PFC regulations adopted by the FAA and specific FAA approval applicable to the Hobby PFC program. A failure by the City to comply with any of these requirements could result in a reduction or termination of the City's authority to impose PFCs and use such PFCs to finance a portion of the CIP. The PFC approval allows the City to (a) pay debt service on outstanding bonds issued for certain completed Hobby projects, (b) reimburse the Houston Airport System for the unamortized cost of certain other Hobby projects that were originally funded from the Houston Airport System's resources (the Airports Improvement Fund), (c) provide pay-as-you-go PFC funding of the local share of the costs of certain planned future airfield projects, and (d) pay debt service on commercial paper and future bonds to finance certain Hobby projects. For a discussion of the treatment of PFC Revenues under the Ordinance, see "APPENDIX H." The PFCs have not been pledged or committed to pay debt service on the bonds.

To date, the City has not imposed PFCs at Intercontinental.

Management

The City's airport system is managed and operated by the Houston Airport System, an enterprise system of the City, under the administrative control of the Mayor. The City Controller, as the Chief Financial Officer of the City, maintains the books of account, prepares financial statements and co-signs, with the Mayor, all warrants, contracts and orders for payment of any public funds or money relating to the Houston Airport System. The day-to-day operations of the Houston Airport System are under the direct supervision of the Director of the Houston Airport System, who is appointed by the Mayor, subject to confirmation by the City Council.

Following is selected biographical information concerning certain principal administrative officers of the Houston Airport System:

Richard M. Vacar, Director of the Houston Airport System for the City since January 1998, is responsible for the overall management of the Houston Airport System. He has been employed by the City since August 1995. Prior to assuming this position, he was Deputy Director of Operations and Maintenance for the Houston Airport System and prior to that was the Executive Director for the Sarasota Manatee Airport Authority and Deputy Director of Operations at Burbank Glendale Pasadena Airport. His 30-plus years of aviation experience includes ten years with the FAA and five years as a professional pilot.

Sara Culbreth, Deputy Director of the Houston Airport System for Finance and Administration since April 2005, is responsible for planning, organizing and directing properties, finance, human resources, procurement and warehousing functions. Ms. Culbreth has over 20 years of experience within the public and private sectors in the areas of financial management, accounting and auditing. Prior to joining the staff at the Houston Airport System, Ms. Culbreth served in various capacities with the City of Houston, including Deputy Director of Public Works and Engineering–Resource Management, Deputy Chief Administrative Officer for the City, Acting Director of Finance, Deputy Director of Management and Finance for the Parks and Recreation Department and Assistant City Controller. Prior to employment with the City of Houston, she was the Finance Director for the cities of Beaumont and Jasper, Texas, and for eight years was the audit partner for a public accounting firm. Ms. Culbreth has a Bachelor of Business Administration from Stephen F. Austin State University and is a Certified Public Accountant.

Eric R. Potts, Deputy Director of the Houston Airport System for Planning, Design and Construction since November 2000, is responsible for all planning, design and construction activities. Prior to assuming this position, Mr. Potts was the Executive Director of the Civil Works Directorate, U.S. Army Corps of Engineers with responsibility for the coordination of staff who supervised the nationwide Civil Works activities of eight major commands and 38 districts, employing 300 officers, and 26,000 civilian employees. Projects under this group include providing navigation, flood damage reduction, and environmental restoration to the Nation. A career Army officer, Mr. Potts held a number of command and staff positions in the U.S. and Germany.

Thomas B. Bartlett, Deputy Director of the Houston Airport System for Operations Services since February 2003, is responsible for the daily operations, maintenance and administration of the three airports. Between March 2000 and February 2003, Mr. Bartlett served as the Deputy Director of the Houston Airport System for Intercontinental Airport (this position has since been incorporated into Operations Services). Mr. Bartlett has over 30 years of related aviation and aeronautical experience and education including over 20 years of increasingly responsible management experience with the Houston Airport System. Mr. Bartlett is a graduate of Embry-Riddle Aeronautical University and holds a commercial pilot's license with an instrument rating and is also a certified flight and ground instructor.

Mark V. Mancuso, Deputy Director of the Houston Airport System for Public Safety and Technology since April 2002, is responsible for all police and fire operations as well as all security and information technology issues for Intercontinental, Hobby, and Ellington. Prior to his assuming this position, Mr. Mancuso served with the Houston Police Department for 31 years and was the Captain (division commander) assigned to Intercontinental Airport for 18 years. Additionally, Mr. Mancuso has over 20 years of experience as a risk management consultant, is qualified as an expert witness in the field of airport security and is recognized as a consulting expert in the area of high-value freight logistics and cargo security.

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HOUSTON AIRPORT SYSTEM OPERATING STATISTICS

The following schedules set forth certain statistical information regarding the Houston Airport System as provided by the City.

Schedule 1: Passenger Statistics. Schedule 1 indicates total passenger growth over the period between FY 1997 and FY 2006. Other than FY 2002 and FY 2003 which were impacted by the events of September 11th, the Houston Airport System shows a constant growth with a compound annual growth rate for the 10-year period of 3.7% with most of the growth at Intercontinental (4.1% for domestic passengers and 147.7% for international for a combined growth of 4.6%). Hobby, which offers no international service, has stayed relatively level over the 10-year period. All commercial passenger activity ceased at Ellington in September 2004.

	Domestic Passengers Intercontinental		Domestic Passengers Hobby		Domestic Passengers[1] Total		International Passengers[2] Intercontinental		Total Passengers[1]	
Fiscal Year	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change
1997	23,839	5.8%	8,330	1.5%	32,270	4.6%	3,614	14.8%	35,884	5.6%
1998	25,543	7.1%	8,597	3.2%	34,253	6.1%	4,161	15.1%	38,414	7.1%
1999	27,271	6.8%	8,795	2.3%	36,166	5.6%	4,801	15.4%	40,967	6.6%
2000	28,892	5.9%	9,053	2.9%	38,034	5.2%	5,340	11.2%	43,374	5.9%
2001	30,105	4.2%	9,038	-0.2%	39,207	3.1%	5,811	8.8%	45,018	3.8%
2002	28,168	-6.4%	8,192	-9.4%	36,428	-7.1%	5,556	-4.4%	41,984	-6.7%
2003	27,931	-0.8%	7,796	-4.8%	35,808	-1.7%	5,526	-0.5%	41,334	-1.5%
2004	29,473	5.5%	8,089	3.8%	37,642	5.1%	5,952	7.7%	43,594	5.5%
2005	31,609	7.2%	8,247	2.0%	39,870	5.9%	6,818	14.5%	46,688	7.1%
2006	34,105	7.9%	8,423	2.1%	42,528	6.7%	7,126	4.5%	49,654	6.4%
2006 (July 2005-March 2006)	24,981		6,193		31,174		5,183		36,357	
2007* (July 2006-March 2007)	26,145	4.7%	6,317	2.0%	32,462	4.1%	5,530	6.7%	37,992	4.5%

* Preliminary figures for FY07.
[1] The Houston Airport System Total also include enplanements and deplanements for Ellington between fiscal years 1997-2005. In its highest year, Ellington had 113 (in thousands) enplanements and deplanements. All commercial passenger service at Ellington ceased in September 2004.
[2] Hobby does not provide international service.

Schedule 1A: Total Enplaned Passengers for the Houston Airport System. Schedule 1A indicates the originating enplaned passengers between FY 1997 and FY 2006. As with Schedule 1, there is continued growth with the exception of FY 2002 and FY 2003 for a compound annual growth rate over the 10-year period of 2.7%. During the first nine months of fiscal year 2007, approximately 48.7% of the enplaned passengers at Intercontinental and 78% of the enplaned passengers at Hobby were originating enplaned passengers.

Intercontinental Airport

Fiscal Year ended June 30	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
1997	6,900,893	7,326,384	14,227,277	48.5%
1998	6,964,583	7,812,905	14,777,488	47.1%
1999	8,323,914	7,725,343	16,049,257	51.9%
2000	8,839,346	8,172,995	17,012,341	52.0%
2001	9,139,616	8,746,479	17,886,095	51.1%
2002	7,934,632	8,876,817	16,811,449	47.2%
2003	7,820,907	8,842,781	16,663,688	46.9%
2004	8,626,935	9,066,201	17,693,136	48.8%
2005	9,326,276	9,872,313	19,198,589	48.6%
2006	9,983,652	10,692,215	20,675,867	48.3%
2006 (July 2005-March 2006)	7,265,893	7,816,274	15,082,167	48.2%
2007 (July 2006-March 2007)*	7,706,503	8,129,670	15,836,173	48.7%

Hobby Airport

Fiscal Year ended June 30	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
1997	3,472,601	666,370	4,138,971	83.9%
1998	3,525,131	775,193	4,300,324	82.0%
1999	3,513,843	883,860	4,397,703	79.9%
2000	3,585,312	932,620	4,517,932	79.4%
2001	3,564,988	953,505	4,518,493	78.9%
2002	3,166,701	927,932	4,094,633	77.3%
2003	2,994,073	904,483	3,898,556	76.8%
2004	3,103,828	940,732	4,044,560	76.7%
2005	3,236,719	914,007	4,150,726	78.0%
2006	3,313,974	922,244	4,236,218	78.2%
2006 (July 2005-March 2006)	2,459,266	649,800	3,109,066	79.1%
2007 (July 2006-March 2007)*	2,474,125	696,194	3,170,319	78.0%

Houston Airport System (1)

Fiscal Year ended June 30	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
1997	10,428,968	7,992,754	18,421,722	56.6%
1998	10,547,117	8,588,098	19,135,215	55.1%
1999	11,890,082	8,609,203	20,499,285	58.0%
2000	12,471,384	9,105,615	21,576,999	57.8%
2001	12,738,648	9,699,984	22,438,632	56.8%
2002	11,137,116	9,804,749	20,941,865	53.2%
2003	10,857,245	9,747,264	20,604,509	52.7%
2004	11,772,263	10,006,933	21,779,196	54.1%
2005	12,570,835	10,786,320	23,357,155	53.8%
2006	13,297,626	11,614,459	24,912,085	53.4%
2006 (July 2005-March 2006)	9,725,159	8,466,074	18,191,233	53.5%
2007 (July 2006-March 2007)*	10,180,628	8,825,864	19,006,492	53.6%

* Preliminary figures for FY 2007.

(1) The Houston Airport System Totals also include enplanements for Ellington between fiscal years 1997-2005. In its highest year, Ellington had 57,403 originating and total enplaned passengers. All commercial passenger service at Ellington ceased in September 2004.

Schedule 2: Airline Market Shares. Schedule 2 shows the airline market shares for FY 2005 and FY 2006. Continental and its affiliate partners represented 84.4% of the passengers in FY 2005 and 86.5% in FY 2006 at Intercontinental. Southwest represented 86.4% and 88.0% of the passengers at Hobby during FY 2005 and FY 2006, respectively. During FY 2006, Continental and its affiliate partners represented 71.9% and Southwest represented 14.9% of the passenger traffic for the full Houston Airport System. For the first nine months of FY 2007, Continental and its affiliate partners represented 87.8% of the passengers at Intercontinental and 73.2% for the full Houston Airport System and Southwest represented 86.5% at Hobby and 14.4% for the full Houston Airport System.

	Intercontinental				Hobby				Houston Airport System			
Domestic	Fiscal Year 2005		Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2006	
Airlines	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
Air Tran	0	0.0%	0	0.0%	341,950	4.1%	339,652	4.0%	341,950	0.7%	339,652	0.7%
America West	454,592	1.2%	367,327	0.9%	0	0.0%	0	0.0%	454,592	1.0%	367,327	0.7%
American Airlines, Inc.	1,052,115	2.7%	1,075,834	2.6%	71,887	0.9%	55,324	0.7%	1,124,002	2.4%	1,131,158	2.3%
American Connection	0	0.0%	0	0.0%	0	0.0%	15,558	0.2%	0	0.0%	15,558	0.0%
American Eagle - AA	0	0.0%	0	0.0%	231,280	2.8%	263,438	3.1%	231,280	0.5%	263,438	0.5%
ATA Airlines	0	0.0%	0	0.0%	0	0.0%	51,212	0.6%	0	0.0%	51,212	0.1%
Atlantic Southeast - DL	117,864	0.3%	133,327	0.3%	111,435	1.4%	100,629	1.2%	229,299	0.5%	233,956	0.5%
Charter Airlines	20,623	0.1%	2,555	0.0%	2,384	0.0%	4,357	0.1%	23,007	0.0%	6,912	0.0%
Chautauqua Airlines - DL	43,897	0.1%	0	0.0%	0	0.0%	10,761	0.1%	43,897	0.1%	10,761	0.0%
Chautauqua Airlines - UA	89,074	0.2%	16,330	0.0%	0	0.0%	0	0.0%	89,074	0.2%	16,330	0.0%
Colgan - Air Inc, - CO	63,671	0.2%	511,621	1.2%	0	0.0%	0	0.0%	63,671	0.1%	511,621	1.0%
Comair - DL	64,440	0.2%	103,296	0.3%	18,295	0.2%	0	0.0%	82,735	0.2%	103,296	0.2%
Continental	19,898,394	51.8%	20,940,495	50.8%	28,045	0.3%	0	0.0%	19,926,439	42.7%	20,940,495	42.2%
ExpressJet Airlines, Inc. - CO	6,720,126	17.5%	8,478,037	20.6%	14,590	0.2%	0	0.0%	6,749,095	14.5%	8,478,037	17.1%
Delta	624,435	1.6%	528,212	1.3%	303,853	3.7%	139,753	1.7%	928,288	2.0%	667,965	1.3%
Frontier	189,928	0.5%	171,639	0.4%	0	0.0%	0	0.0%	189,928	0.4%	171,639	0.3%
Mesa Airlines, Inc. - America West	1,882	0.0%	40,743	0.1%	0	0.0%	0	0.0%	1,882	0.0%	40,743	0.1%
Mesa Airlines, Inc. - US	399	0.0%	148,648	0.4%	0	0.0%	0	0.0%	399	0.0%	148,648	0.3%
Midwest Airlines, Inc.	0	0.0%	0	0.0%	0	0.0%	19,971	0.2%	0	0.0%	19,971	0.0%
MN Airlines, Inc.	0	0.0%	0	0.0%	0	0.0%	7,073	0.1%	0	0.0%	7,073	0.0%
Northwest	677,689	1.8%	600,100	1.5%	0	0.0%	0	0.0%	677,689	1.5%	600,100	1.2%
PSA Airlines - US	59,481	0.2%	30,909	0.1%	0	0.0%	0	0.0%	59,481	0.1%	30,909	0.1%
Republic Airlines - US	0	0.0%	57,027	0.1%	0	0.0%	0	0.0%	0	0.0%	57,027	0.1%
Shuttle America Corporation - UA	0	0.0%	135,294	0.3%	0	0.0%	0	0.0%	0	0.0%	135,294	0.3%
SkyWest Airlines - CO	292,458	0.8%	48	0.0%	0	0.0%	0	0.0%	292,458	0.6%	48	0.0%
SkyWest Airlines - DL	0	0.0%	2,809	0.0%	0	0.0%	0	0.0%	0	0.0%	2,809	0.0%
SkyWest Airlines - UA	14,306	0.0%	72,382	0.2%	0	0.0%	0	0.0%	14,306	0.0%	72,382	0.1%
Southwest Airlines Company	167,757	0.4%	0	0.0%	7,123,101	86.4%	7,415,573	88.0%	7,290,858	15.6%	7,415,573	14.9%
United Air Lines, Inc.	625,191	1.6%	465,768	1.1%	0	0.0%	0	0.0%	625,191	1.3%	465,768	0.9%
US Airways	430,220	1.1%	222,137	0.5%	0	0.0%	0	0.0%	430,220	0.9%	222,137	0.4%
Total Domestic	31,608,542	82.3%	34,104,538	82.7%	8,246,820	100.0%	8,423,301	100.0%	39,869,741	85.4%	42,527,839	85.6%
International	Fiscal Year 2005		Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2006	
	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
AeroMexico	127,672	0.3%	140,916	0.3%	0	0.0%	0	0.0%	127,672	0.3%	140,916	0.3%
Aerolitoral	183	0.0%	80	0.0%	0	0.0%	0	0.0%	183	0.0%	80	0.0%
Air Canada	72,122	0.2%	21,738	0.1%	0	0.0%	0	0.0%	72,122	0.2%	21,738	0.0%
Air Canada Jazz	66,058	0.2%	156,704	0.4%	0	0.0%	0	0.0%	66,058	0.1%	156,704	0.3%
Air France	156,596	0.4%	194,632	0.5%	0	0.0%	0	0.0%	156,596	0.3%	194,632	0.4%
Air Jamaica	16,441	0.0%	0	0.0%	0	0.0%	0	0.0%	16,441	0.0%	0	0.0%
Aviacsa	107,307	0.3%	70,363	0.2%	0	0.0%	0	0.0%	107,307	0.2%	70,363	0.1%
British Airways	193,060	0.5%	217,221	0.5%	0	0.0%	0	0.0%	193,060	0.4%	217,221	0.4%
Cayman Airways, LTD.	10,775	0.0%	13,291	0.0%	0	0.0%	0	0.0%	10,775	0.0%	13,291	0.0%
Charter Airlines	103,903	0.3%	54,113	0.1%	0	0.0%	0	0.0%	103,903	0.2%	54,113	0.1%
China Airlines	54,456	0.1%	54,614	0.1%	0	0.0%	0	0.0%	54,456	0.1%	54,614	0.1%
Continental	4,404,803	11.5%	4,454,118	10.8%	0	0.0%	0	0.0%	4,404,803	9.4%	4,454,118	9.0%
ExpressJet Airlines, Inc. - CO	1,039,670	2.7%	1,292,759	3.1%	0	0.0%	0	0.0%	1,039,670	2.2%	1,292,759	2.6%
KLM	220,939	0.6%	215,816	0.5%	0	0.0%	0	0.0%	220,939	0.5%	215,816	0.4%
Lufthansa	145,599	0.4%	147,894	0.4%	0	0.0%	0	0.0%	145,599	0.3%	147,894	0.3%
Pakistan Int'l Airlines	28,692	0.1%	30,454	0.1%	0	0.0%	0	0.0%	28,692	0.1%	30,454	0.1%
TACA	69,510	0.2%	61,265	0.1%	0	0.0%	0	0.0%	69,510	0.1%	61,265	0.1%
Total International	6,817,786	17.7%	7,125,978	17.3%	0	0.0%	0	0.0%	6,817,786	14.6%	7,125,978	14.4%
Total Airlines	38,426,328	100.0%	41,230,516	100.0%	8,246,820	100.0%	8,423,301	100.0%	46,687,527	100.0%	49,653,817	100.0%

(1) Houston Airport System totals include 14,379 ExpressJet passengers in FY 2005 at Ellington. Commercial passenger traffic at Ellington ceased in September 2004.

Schedule 3: Total Aircraft Operations And Aircraft Landed Weight. Schedule 3 shows the Aircraft Operations and Aircraft Landing Weight for the Houston Airport System.

	Aircraft Operations (in thousands)			Aircraft Landed Weight (in million pounds)		
Fiscal Year	Total	Increase (Decrease)	Percentage Change	Total	Increase (Decrease)	Percentage Change
1997	768	34	4.63%	26,822	744	2.85%
1998	789	21	2.73%	28,253	1,431	5.34%
1999	796	7	0.89%	30,119	1,866	6.60%
2000	827	31	3.89%	31,495	1,376	4.57%
2001	823	-4	-0.48%	32,083	588	1.87%
2002	790	-33	-4.01%	30,496	-1,587	-4.95%
2003	811	21	2.66%	30,802	306	1.00%
2004	856	45	5.55%	31,444	642	2.08%
2005	887	31	3.62%	32,543	1,099	3.50%
2006	933	46	5.19%	32,808	265	0.81%
2006 (July 2005-March 2006)	688			24,440		
2007* (July 2006-March 2007)	733	45	6.54%	25,267	827	3.38%

* Preliminary figures for FY07

HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION

Schedule 4 sets forth, for the Fiscal Years indicated, (1) the Gross Revenues, Operation and Maintenance Expenses and Net Revenues (each computed as defined in the Ordinance) of the Houston Airport System, (2) the total Debt Service Requirement (computed as defined in the Ordinance) on then Outstanding Houston Airport System Bonds, which include all obligations payable from revenues of the Houston Airport System and (3) the coverage of Debt Service Requirement by Net Revenues. All amounts in "Schedule 4–Selected Financial Information" for Fiscal Years 2002 through 2006 are derived from the audited financial statements of the Houston Airport System Fund or from the supplementary information and the statistical section included in the City Controller's Comprehensive Annual Financial Report of the City of Houston, Texas, for each respective Fiscal Year. Nine-month comparative figures shown for Fiscal Years 2006 and 2007 were generated from the internal financial reports of the City and have not been audited by the City's auditors. The schedule should be read in conjunction with the complete audited financial statements of the City of Houston, Texas, Airport System Fund Component Unit Financial Report and the notes thereto included as APPENDIX B.

Net Revenues of the Houston Airport System decreased from $101.8 million in Fiscal Year 2002 to $97.4 million in Fiscal Year 2003 largely due to the after-effects of September 11, 2001. Such after-effects included a reduction of passenger traffic affecting parking and concessions, compounded by increases in expenditure for security-related initiatives. Several projects were not included in rates and charges for those years, but were subsequently included at full cost and amortized over a shorter period. Net Revenues increased to $117.3 million in Fiscal Year 2004, to $177.2 million in Fiscal Year 2005, and to $206 million in Fiscal Year 2006. The Fiscal Year 2005 increase in Operating Revenues was primarily due to adding three runway projects and a partial year of the ISEP into the rates and charges. The Fiscal Year 2006 increase in Operating Revenues was primarily due a full year of the ISEP in the rates and charges.

Operation and Maintenance Expenses increased following the events of September 11, 2001, as a result of both increased security costs and new facilities that have been placed in service. From Fiscal Year 2002 to Fiscal Year 2006, Personnel and Other Current Expenses increased from $143 million to $205.6 million, an average annual increase of 9.1%.

Beginning in Fiscal Year 2005, the Houston Airport System began paying interest on the City's pension bonds and note. See "THE CITY OF HOUSTON AND CITY FINANCIAL INFORMATION–Employee Pension Funds."

Sources of Operating Revenues

Operating Revenues of the Houston Airport System are generated from the following revenue-producing sources:

Landing Fees. Landing fees for scheduled airlines at Intercontinental and Hobby are computed under formulas derived from various use and lease agreements and license agreements (see "HOUSTON AIRPORT SYSTEM AGREEMENTS–Use and Lease Agreements"), which rates are also applied by ordinance to nonscheduled, commercial aircraft and nonsignatory scheduled aircraft landings at both airports based upon maximum FAA-approved gross landed weights. In addition, the City receives revenues from aviation fuel flowage fees (currently six cents per gallon) assessed on the delivery of fuel to certain aircraft in lieu of landing fees. The City suspended such fuel flowage fees at Intercontinental beginning in November 2000 and reinstated them in February 2004.

Building and Ground Area Revenues. Terminal space rentals paid by scheduled airlines, other than at Terminal D, under use and lease agreements are subject to annual compensatory adjustment depending upon additional capital improvements, maintenance, operating and overhead expenses allocable to the facilities. License agreement charges for Terminal D are based upon a cost-based methodology substantially similar to that employed pursuant to the other use and lease agreements. Ground rentals are charged by the City under long-term ground leases of land at Intercontinental, Hobby, and Ellington. The City leases various parcels of land as follows: to airlines, fixed base operators and various corporations for hangars, aircraft maintenance facilities, flight kitchens and cargo buildings; to auto rental companies for their service facilities and storage lots; and to a variety of other entities for buildings and other permanent improvements.

Parking, Concession, and Other Revenues. City-owned parking facilities are the largest single source of revenues of the Houston Airport System other than payments by the airlines. As of June 30, 2007, such facilities consisted of approximately 23,624 public parking spaces at Intercontinental and approximately 4,060 at Hobby. Auto parking operations are managed by the Houston Airport System and are operated by New South Parking pursuant to a concession agreement with the City. See "HOUSTON AIRPORT SYSTEM AGREEMENTS–Other Agreements." Parking rates are approved by the City Council of the City. The City's parking facilities compete with several off-airport private parking operators that provide free shuttle service to their customers at both Intercontinental and Hobby. Accordingly, competitive supply and demand constraints affect the City's ability to continue to generate parking revenues.

Concessions include news and gift shops, restaurants, lounges, auto rentals, advertising and operation of the 565 guest-room Marriott Hotel, which is the City-owned hotel located at Intercontinental. The hotel lease and other terminal concession agreements provide for annual payments based on the greater of a percentage of gross income or guaranteed minimums.

Revenues from auto rentals are derived from a concession fee (in addition to certain ground rentals) paid by auto rental companies to the City as either a percentage of the gross auto rentals or a guaranteed minimum, whichever is greater.

Funds must be generated primarily from parking and other concession revenues and from investment income and other nonoperating revenues in order to (1) cover the Houston Airport System's operating expenses and amortization of capital costs not attributable to facilities and services used by the airlines, (2) produce surplus to meet current or anticipated needs of the Houston Airport System, and (3) comply with the Rate Covenant. In Fiscal Year 2006, Continental Airlines (including its commuter partner, ExpressJet Airlines) and Southwest accounted for 48.2% and 7.9%, respectively, of operating revenues of the Houston Airport System.

Schedule 4: Selected Financial Information.

FISCAL YEARS

(Dollars in Thousands)

	2002	2003	2004	2005	2006	2006 (9 months)[1]	2007 (9 months)[1]
OPERATING REVENUES:							
Landing Fees:							
Landing Fees	$ 49,424	$ 49,211	$ 53,906	$ 99,197	$ 98,385	$ 75,188	$ 75,567
Aviation Fuel	838	910	1,112	1,400	1,559	1,121	992
Aircraft Parking	564	1,041	1,993	1,475	1,814	1,390	1,266
Subtotal	50,826	51,162	57,011	102,072	101,758	77,699	77,825
Building and Ground Area Revenues:							
Terminal Space	73,116	79,547	101,040	136,074	162,491	118,638	133,634
Cargo Building	1,863	1,638	982	893	1,553	1,253	1,245
Other Rentals	2,262	2,192	3,065	3,354	3,801	2,751	3,972
Hangar Rental	1,902	2,499	2,499	2,077	2,349	1,719	1,779
Ground Rental	5,607	5,923	8,189	9,018	9,757	6,765	5,817
Concourse Security	2	2	2	1	-	-	-
Subtotal	84,752	91,801	115,777	151,417	179,951	131,126	146,447
Parking, Concession and Other Revenues:							
Terminal Concessions	22,444	25,355	22,563	19,823	21,070	15,502	18,685
Auto Parking	46,955	50,103	51,437	55,444	62,377	45,782	48,637
Auto Rental	16,886	15,978	16,800	18,065	21,438	16,206	16,518
Ground Transportation	3,274	3,834	3,737	3,954	3,999	3,165	3,559
Other Operating Income	2,318	2,534	3,088	2,866	3,268	2,963	2,682
Subtotal	91,877	97,804	97,625	100,152	112,152	83,618	90,081
TOTAL OPERATING REVENUES:	227,455	240,767	270,413	353,641	393,861	292,443	314,353
NON-OPERATING REVENUES: [2]							
Interest on Investments [2]	12,816	10,650	8,406	10,498	17,742	12,288	19,208
Security Reimbursement Grant	3,711	-	-	-	-	-	-
Other	809	504	114	4,175	(58)	1	72
Subtotal	17,336	11,154	8,520	14,673	17,684	12,289	19,280
TOTAL GROSS REVENUES	$ 244,791	$ 251,921	$ 278,933	$ 368,314	$ 411,545	$ 304,732	$ 333,633
OPERATION AND MAINTENANCE EXPENSES: [3]							
Personnel and Other Current Expenses	142,877	153,173	161,204	223,972	202,496	150,712	153,181
Collaterized Pension Note	-	-	-	(34,800)	-	-	-
Interest on pension bonds and note [4]	-	-	-	1,921	3,069	2,056	2,052
Bad Debt Expenses	73	1,368	441	-	-	-	-
TOTAL OPERATION AND MAINTENANCE EXPENSES:	$ 142,950	$ 154,541	$ 161,645	$ 191,093	$ 205,565	$ 152,768	$ 155,233
NET REVENUES	$ 101,841	$ 97,380	$ 117,288	$ 177,221	$ 205,980	$ 151,964	$ 178,400
DEBT SERVICE REQUIREMENTS OF OUTSTANDING BONDS[1]	$ 51,611	$ 63,988	$ 75,797	$ 112,248	$ 140,513		
Grant Revenue Available for Debt Service	(37,153)	(30,282)	(32,823)	(25,506)	(46,621)		
NET DEBT SERVICE REQUIREMENT: [5]	$ 14,458	$ 33,706	$ 42,974	$ 86,742	$ 93,892		
COVERAGE OF DEBT SERVICE REQUIREMENTS BY REVENUES	7.04	2.89	2.73	2.04	2.19		

[1] Unaudited.
[2] The figures shown have been adjusted for revenues not defined as Gross Revenues or Net Revenues in the Ordinance.
[3] Does not include depreciation expenses.
[4] Portion of debt of the City of Houston allocated to the Airport System.
[5] Does not include debt service for which interest was capitalized from bond proceeds or provided from other sources other than Net Revenues such as grant funds. See definition of "Debt Service Requirements" in APPENDIX H.

Schedule 5: Summary of Certain Fees and Charges. [(1)] Schedule 5 contains the established rates and charges for Fiscal Year 2006 and Fiscal Year 2007 as set forth in the Use and Lease Agreements for Intercontinental and Hobby.

	Intercontinental		**Hobby**	
	Fiscal Year 2006	Fiscal Year 2007	Fiscal Year 2006	Fiscal Year 2007
Landing Rates [(2)]	$3.190	$3.069	$2.711	$2.814
Terminal Space Rentals [(3)]	$19.28 - $86.56	$25.32 - $89.03	$42.90 - $73.02	$40.39 - $72.44
Apron [(3)]	$1.759 - $3.243	$2.373 - $3.636	$2.529 - $3.722	$2.477 - $3.245
Parking Rates (maximum per day)				
Economy	$6.00	$6.00	$6.00	$6.00
Structured	$13.00	$12.00	$13.00	$12.00
Surface	--	$9.00	--	--
Short-Term	--	$30.00	--	$30.00
Sure Park	$15.00	$15.00	--	--

(1) Unaudited.
(2) Per 1,000 pounds for landed weight.
(3) Range per square foot.

DEBT SERVICE REQUIREMENTS OF HOUSTON AIRPORT SYSTEM BONDS

Schedule 6 sets forth the Debt Service Requirements, computed as defined in APPENDIX H, on all Outstanding Houston Airport System Subordinate Lien Bonds, assuming scheduled mandatory redemption of any term bonds and reflecting the scheduled payments for the Inferior Lien-level lease obligations. This schedule is adjusted to include the Bonds and exclude the Refunded Bonds.

Schedule 6: Houston Airport System Debt Service Requirements Schedule. (1)

Year Ending (July 1)	Outstanding Subordinate Lien Debt Service(2)	Series 2007B Bonds Debt Service	Refunded Debt Service	Total Subordinate Lien Bond Debt Service	Series 1997A Bond-Related Lease Payments(3)	Net Debt Service Payable from Airport Revenues
2008	$ 152,539,209	$ 12,606,461	$ 14,075,015	$ 151,070,655	$ 6,586,519	$ 157,657,174
2009	152,532,510	16,267,638	14,075,015	154,725,133	6,582,969	161,308,101
2010	152,523,087	16,265,838	14,075,015	154,713,910	6,583,400	161,297,310
2011	152,618,147	16,266,638	14,075,015	154,809,770	6,582,006	161,391,776
2012	152,619,589	17,994,838	15,900,015	154,714,412	6,583,250	161,297,662
2013	152,699,983	17,991,238	15,901,484	154,789,737	6,586,325	161,376,062
2014	152,686,325	17,992,238	15,898,084	154,780,479	6,584,125	161,364,604
2015	152,691,066	17,987,438	15,899,815	154,778,688	6,581,800	161,360,488
2016	152,686,400	17,981,988	15,896,165	154,772,223	6,583,525	161,355,748
2017	152,652,492	17,980,675	15,892,134	154,741,033	6,583,200	161,324,233
2018	152,655,706	22,214,050	20,377,465	154,492,291		154,492,291
2019	152,628,671	23,023,300	21,229,971	154,422,000	-	154,422,000
2020	152,632,074	23,015,300	21,220,571	154,426,803	-	154,426,803
2021	152,703,876	17,147,800	15,008,009	154,843,667	-	154,843,667
2022	152,701,196	21,810,150	19,947,203	154,564,144	-	154,564,144
2023	152,660,453	13,939,150	11,610,790	154,988,813	-	154,988,813
2024	152,668,513	13,941,650	11,610,790	154,999,373	-	154,999,373
2025	152,650,889	30,093,000	28,725,790	154,018,099	-	154,018,099
2026	152,660,504	30,094,250	28,730,235	154,024,519	-	154,024,519
2027	152,385,926	30,092,750	28,728,820	153,749,856	-	153,749,856
2028	152,084,628	30,091,250	28,723,695	153,452,183	-	153,452,183
2029	152,162,424	71,587,250	72,697,375	151,052,299	-	151,052,299
2030	152,087,784	71,593,250	72,700,050	150,980,984		150,980,984
2031	152,810,092	2,982,250		155,792,342	-	155,792,342
2032	152,786,896	2,982,000		155,768,896		155,768,896
	$3,814,528,440	$573,942,386	$532,998,520	$3,855,472,307	$65,837,119	$3,921,309,425

(1) Unaudited. Discrepancies in totals may exist due to rounding.

(2) Debt service for the Series 2000P-1 and 2000P-2 Bonds has been computed at the certified rate of 5.85%. Debt service for the 2002C, 2002D-1, and 2002D-2 Bonds has been computed at the certified rate of 5.30%. Debt service for the Series 2005A Bonds has been computed at the certified rate of 5.25%. See “ADDITIONAL FINANCING” for discussion of the Series 2007A Bonds that are expected to be issued in the near future.

(3) July 15 payments made by the City pursuant to its sublease of the APM are included in the total for the prior Fiscal Year ending July 1. These payments reflect amounts equal to the debt service on the Airport System Special Facilities Revenue Bonds, Series 1997A.

Schedule 7: Houston Airport System Outstanding Debt. The following Schedule 7 summarizes Airport System debt outstanding as of July 15, 2007, adjusted to include the Bonds and exclude the Refunded Bonds and Refunded Notes.[(1)]

	As of July 15, 2007 (In thousands)
Senior Lien Revenue Bonds[(2)]	$ 52,000
Subordinate Lien Revenue Bonds, fixed rate	1,695,455
Subordinate Lien Revenue Bonds, periodic auction rate[(3)]	344,675
Subordinate Lien Revenue Bonds, variable rate[(4)]	92,900
Inferior Lien Obligations[(5)(6)]	49,700
Total Outstanding Principal	$ 2,234,730
Special Facilities Revenue Bonds[(6)(7)]	$ 590,920

(1) Unaudited.

(2) The City has authorized issuance of up to $150 million of Airport System Senior Lien Commercial Paper Notes, Series A and B. It is expected that the remaining outstanding Notes will be refunded with proceeds of the 2007A Bonds.

(3) This reflects the principal amount of the Series 2000P1 and 2000P2 auction rate bonds, and 2002C, 2002D1, and 2002D2 auction rate bonds. The auction rate bonds are not short term/demand obligations as defined in the bond ordinances authorizing the issuance of the Houston Airport System Bonds.

(4) This reflects the principal amount of the Series 2005A variable rate demand obligations.

(5) The City has authorized issuance of up to $150 million of Airport System Inferior Lien Commercial Paper Notes, Series C.

(6) Under a sublease to the City of the APM financed with the Series 1997A Special Facilities Bonds, the City has agreed to make sublease payments that include amounts equal to the debt service on such bonds. Such payments are payable from Houston Airport System Net Revenues on the same priority as Inferior Lien Obligations. Accordingly, for purposes of this schedule, the Series 1997A Special Facilities Bonds are listed as Inferior Lien Bonds rather than as Special Facilities Bonds, even though they remain outstanding as Special Facilities Bonds.

(7) Special facilities revenue bonds are payable solely from payments by special facilities leases and/or other security not provided by the City or the Houston Airport System.

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HOUSTON AIRPORT SYSTEM AGREEMENTS

Use and Lease Agreements

General. At both Intercontinental and Hobby, most landing fees and terminal rentals are paid by the airlines pursuant to use and lease agreements. Those agreements generally require the airlines to pay landing fees, terminal building rentals and certain other charges to enable the City to recover costs allocable to facilities occupied and used by the airlines. These costs include Operation and Maintenance Expenses, amortization charges associated with the City's investment in airport capital improvements and interest on the City's investment in land. Those airlines that do not operate under use and lease agreements generally operate under agreements or arrangements on a month-to-month basis or under City ordinance.

The City has the following use and lease agreements with the airlines operating at Intercontinental and Hobby: (1) Continental and the City entered into a use and lease agreement (the "Continental Use and Lease Agreement"), effective as of January 1, 1998 with respect to Terminal B and Terminal C at Intercontinental, and a lease agreement for Terminal E, dated as of August 1, 2001; (2) the City entered into use and lease agreements with the other airlines operating and occupying space and gates in the expanded Terminal A at Intercontinental (the "Terminal A Airlines"), effective as of January 1, 1998; (3) the City has entered into International Facilities Agreements governing the use of Terminal D and the Central FIS with Continental, World Airways, Pakistan International, China Airlines, KLM, TACA, Aeromexico, Lufthansa, Air France, Aviacsa, British Airways, and Cayman; and (4) the City has entered into use and lease agreements with Southwest and the other airlines at Hobby, effective as of January 1, 1998.

The following section summarizes the major provisions of the Houston Airport System's use and lease agreements and license agreements.

Continental Use and Lease Agreement. Under the Continental Use and Lease Agreement, the term of Continental's lease of Terminal C premises is 20 years, effective retroactively from January 1, 1998 to December 31, 2017, which is the remaining portion of the amortization period of the original Terminal C investment. To facilitate Continental's hub operations at Intercontinental, Continental has the preferential right to use all of the apron area and exclusive right to use of all of the holdrooms and other airline space in Terminal C for the duration of the lease term. The original term of Continental's lease for Terminal B is 10 years, effective from January 1, 1998 through December 31, 2007; Continental has exercised its option to extend the term of the lease for an additional 10 years to December 31, 2017. Continental also has the preferential right to use all of the aircraft parking positions and exclusive right to use of all of the holdrooms and other airline space in Terminal B, subject to the City's right under certain conditions to require Continental to relinquish such space because of under-utilization. As of January 25, 2005, the City subleases the Terminal B-C link of the APM from Continental and includes it in the rates and charges for Terminals B, C, D, E, and the Central FIS.

In calculating airline fees, rentals and charges at Intercontinental, costs of support facilities such as the interterminal train system and the chilled and hot water plant are allocated among the various areas benefiting from such facilities, including airline areas of the terminal buildings. In addition, the City charges apron fees that are calculated to recover costs allocable to the aprons. Landing fees under the Continental Use and Lease Agreement continue to be calculated according to a "cost center residual cost" formula through which Continental is required to pay all costs allocable to the airfield cost center after first deducting airfield revenues derived from general aviation (principally fuel flowage fees, if any).

With respect to terminal building rental rates, the Continental Use and Lease Agreement provides for a "compensatory" rate-making methodology that has been in effect since the airport opened in 1969 which includes: (1) the City treating each terminal at Intercontinental (Terminals A, B, C, D, E, the Central FIS and the APM) as a separate cost center for rates and charges purposes and (2) computing capital costs in the airline rate base (terminals and airfield) to reflect level annual amortization of investments. Costs associated with public and concession areas of the terminals are the responsibility of the City and are recovered through concession revenues (including parking, rental car and ground transportation revenues) and other non-airline revenues. The rate base in Terminal B includes a "base capital charge" of $6.50 per square foot to compensate the City for the economic value of depreciated facilities.

The City has retained the discretion to make capital investment decisions and issue Additional Airport Bonds, as needed, to ensure that adequate facilities are provided on a timely basis to meet public and airline needs. See "THE CITY AND THE HOUSTON AIRPORT SYSTEM–Houston Airport System Capital Improvement Program."

Continental Terminal E Lease. The term of Continental's lease of Terminal E project facilities (including Terminal E, central ticketing facility, Terminal E baggage system improvements, Terminal C-East garage ATO facility, Terminal E apron area and fueling facilities and ancillary facilities) is from August 29, 2001 until the later of (i) the final scheduled maturity of the bonds issued to finance the Terminal E project or (ii) 25 years from January 25, 2005, the date of beneficial occupancy of the Central FIS. Continental has the option to extend the term for an additional 5-year period, subject to certain conditions. Continental net leased the facilities on an exclusive basis with the exception of the Terminal E Apron area and fueling facilities which are leased on a preferential basis.

As security for the Series 2001 Special Facilities Bonds (Terminal E Project), the Terminal E Lease obligates Continental to pay rent, directly to the trustee, equal to debt service on the bonds, In addition, Continental is obligated to pay the City ground rentals for the special facility areas and "city charges" for the portions of the facilities financed by the City as well as certain allocations of project amortization, maintenance, and operations costs, and replenishment of the renewal and extension fund for systems costs, and airport and departmental administrative costs. For the City charges, Terminal E is treated as a separate rates and charges cost center similar in manner to the other terminals as discussed above under the Continental Use and Lease Agreement. In consideration of Continental's net leasing of the entire Terminal E and central ticketing facility (including the public areas), Continental will derive the financial benefit of all "inside concessions" at Terminal E, such as revenues from concession agreements for food and beverage, gift/news, telephone and advertising.

Terminal A Airlines Use and Lease Agreement. The use and lease agreement for the Terminal A carriers operating at Intercontinental are similar to the Continental Use and Lease Agreement with respect to rates and charges methodology and language, but different with respect to term and facility management provisions. The term of the use and lease agreement for the Terminal A carriers is for seven years, commencing from July 1, 1998 to June 30, 2005. These agreements are currently being held over on a month-to-month basis while a new agreement is under discussion. The rate-making provisions are expected to remain substantially the same. Facility management provisions included in such agreements are flexible in comparison to other use and lease agreements utilized by other major airports. In this regard, holdroom space and aircraft parking positions are leased on a preferential use, rather than an exclusive use, basis. In addition, space assignments are subject to annual review and potential reallocation based on a document, the Standard Gate Concept Definition for Preferential Gate Use Policy, which has been developed by the City and incorporated by reference in such agreements. This policy document confirms the City's airport-wide gate utilization standard of four flights per day and defines the standard relationships between assigned gates (based on aircraft size) and various categories of terminal space. The intent of the policy is to ensure balanced use of space and gates in the terminal as airlines change flight activity and terminal use over time. The use and lease agreements for Terminal A also include a base capital charge of $5.00 per square foot (compared to $6.50 in the Continental Use and Lease Agreement) but require the airlines to pay costs of certain unamortized improvements to Terminal A which Continental is not required to pay in Terminal B. The landing fee methodology in the Terminal A use and lease agreements is identical to that of the Continental Use and Lease Agreement.

International Facilities Agreement. Continental and the foreign flag international airlines at Terminal D and the Central FIS operate under the terms of the International Facility Agreement on a month-to-month basis, which will not extend beyond June 30, 2010. The lease agreements set forth the methodology for calculating rates and charges for the use of the facility. The methodology is generally based on the compensatory rate-making concepts in effect in the other terminals, but with separate charges for use of the aircraft parking positions and loading bridges (on a total enplaned and deplaned passenger basis); operations, office, and club room space (on a per square foot basis); ticketing and baggage make-up space (on an enplaned passenger basis); holdrooms, sterile corridors and related space (on a deplaned passenger basis); and Federal Inspection Services and baggage claim areas (on a deplaned passenger basis).

Hobby Use and Lease Agreement. The use and lease agreements for the airlines operating at Hobby are similar in form and substance to the agreements at Intercontinental, but with certain differences in rate-making methodology that resulted in the division of the airport into various sub-cost centers, as follows: (1) with respect to existing facilities, the sub-cost centers include the Main Terminal, Concourse A, Concourse B (until its recent demolition), and Concourse C; and (2) with respect to new or future facilities, the sub-cost centers include the Main Terminal, the Central Concourse and the East Concourse. It was decided to expand the Central Concourse by 5 gates and defer the construction of the East Concourse. There is not expected to be any further division of such cost centers into "airline" and "public/concession space" as is the practice at Intercontinental. Under the Hobby use and lease agreements, the total costs of each cost center will then be divided by the total amount of "usable space" (i.e. gross space less mechanical, electrical, and utility space) in the cost center to determine an average rate that will apply to all leasable space. As at Intercontinental, the costs associated with public and concession space will be covered by concession revenues and other non-airline revenue sources. Under the Hobby use and lease agreements, landing fees are calculated on a "cost center residual cost" formula similar to the use and lease agreements at Intercontinental. The term of the Southwest use and lease agreement is for twelve years, commencing as of July 1, 1998 until June 30, 2010. However, the City has received a new agreement signed by Southwest which will extend until June 30, 2015 with rate making provisions that are substantially the same. The term of the use and lease agreements for the other airlines operating at Hobby is for seven years, effective retroactively from July 1, 1998 until June 30, 2005. These agreements are currently being held over on a month-to-month basis while a new agreement is under discussion. The rate-making provisions are expected to remain substantially the same.

Other Agreements

The City receives revenues from automobile rental companies under agreements which guarantee annual minimum rental amounts or, if greater, a percentage of gross revenues from automobile rentals at both Intercontinental and Hobby. The City has executed agreements with eight rental car companies operating at Intercontinental regarding the new consolidated rental car facility on a site adjacent to J.F. Kennedy Boulevard. The concession agreement and facility lease have terms that expire August 31, 2028, 25 years from the date of beneficial occupancy of the facility. The consolidated rental car facility was financed with proceeds of the Series 2001 Special Facilities Bonds (Rental Car Facility) issued in the principal amount of $130,250,000 in March 2001 that are secured by and payable from a separate customer facility charge ("CFC") assessed on rental car customers at Intercontinental. Under the terms of the lease, the rental car companies are responsible for all operating and maintenance costs associated with the facility and the consolidated busing operation. The City has also executed concession agreements with nine rental car companies operating at Hobby that expire May 31, 2008, with 2 one-year renewal options.

The City leases a hotel, land and parking areas at Intercontinental to Marriott, Inc. The leases entitle the City to the greater of certain guaranteed annual minimum amounts or percentages of gross sales from operations of the hotel facilities each year. The agreements also entitle the City to collect rental payments for the use of parking areas based on the square footage used for hotel parking, and to charge the hotel if chilled and hot water are delivered to and used by the hotel. The leases expire October 30, 2019.

The City also receives revenues from concession agreements with food, alcoholic beverage, gift/news and other concessionaires operating at the terminals. The revenues paid to the City under these concession agreements are based on the greater of certain guaranteed annual minimum amounts or a percentage of gross revenues received by the concessionaires. In July 1998, City Council approved a 10-year food and beverage concession agreement at Intercontinental which has been extended for an additional four years, and in Fiscal Year 2004, a new gift/news concession was awarded at Intercontinental. A new concession for duty free shops was awarded in October 2005. In Fiscal Year 2003, the City awarded new food and beverage and gift/news concessions for the new areas at Hobby.

The Houston Airport System has implemented the phased development of 165 acres of land at the northeast end of Intercontinental reserve as a new cargo area. The first phase involved approximately 104 acres and will provide more than half a million square feet of cargo terminal space, with parking spaces for 20 widebody freighter aircraft. The City has leased to three private developers approximately eight acres of land each (25.5 acres in the aggregate) for cargo development purposes. The developers, IAH Air Cargo Center, L.P. (currently assigned to Industrial Properties Corporation), Aero Houston East, LLC, and TCC/AMB Aviation IAH, L.P. (currently assigned to Aero Houston East II, L.P.), each built, operates and maintains air cargo and warehouse facilities on the northeast side of Intercontinental pursuant to 30-year ground lease with 10-year option agreements with the City. The cargo and warehouse facilities opened in March 2003. The City retains ownership of the property and built the infrastructure surrounding the warehouses, including an apron, taxiway extension and utilities. The leases with the developers provide for annual ground rentals that increase over time and more than recover costs allocable to the building sites. Five acres of the building site have been leased to United Parcel Service ("UPS"), which relocated operations from Ellington to Intercontinental. UPS also leased three jet aircraft and one turbo-prop parking positions under a separate agreement. The cost of the cargo area's taxiways and taxi-lanes is being allocated to the airfield cost center and is recovered from landing fees. The cost of the building area site development is being recovered from ground rentals. The City retains control over the use of the aircraft parking aprons (except for the aircraft parking positions leased to UPS) and charges ramp fees to recover a portion of these costs.

In March 2002, the City of Houston Industrial Development Corporation issued bonds on a conduit basis to finance a project being undertaken by Aero Houston Central, L.P. ("Aero Houston Central") relating to the acquisition of leaseholds on 13 air cargo facilities at Intercontinental (the "Houston Cargo Project"). The Houston Cargo Project is part of a first-of-its-kind financing for the municipal market by combining the financing for buying cargo leases at nine airports scattered across the country, with nine separate airport authorities, into one sale. The sale was divided into two series of fixed-rate private-activity bonds, $57.2 million in Series 2002 senior air cargo revenue bonds and $16.3 million in Series 2002 subordinate air cargo revenue bonds. The Houston Cargo Project is located in the central cargo area on land at Intercontinental that is leased to Aero Houston Central under various ground leases with a maximum lease term of 21 years. Aero Houston Central is obligated to pay ground rent to the Houston Airport System under the terms of a ground lease entered into between the parties. In March 2005, the City and Aero Houston Central executed an agreement whereas Aero Houston Central agreed to take over the leasing of the other remaining cargo facilities in the central cargo area, except for the new Continental cargo building. The agreement provides for Aero Houston Central to pay building rents on the additional facilities beginning retroactively as of January 1, 2005, including buildings that were previously leased to Aero Houston Central. As each lease on buildings that Aero Houston Central currently leases expires, Aero Houston Central will change from the ground rent to a building rent. The lease on the entire area expires on December 31, 2024.

In order to complete the construction of the south taxiway at Intercontinental, in December 2003, the City and Continental executed a lease agreement for the City to construct a new cargo building for Continental. The agreement has a term of 25 years beginning December 12, 2004.

Ellington Field is being used by certain federal government agencies under a joint use agreement between the City and the federal government which expires June 30, 2007.

Houston Airport System is affiliated with HAS Development Corporation (HASDC), a Texas nonprofit corporation, created to provide a mechanism for Houston Airport System to provide (through HASDC) technical expertise to airports around the world in planning, training, operations, privatization and other airport-related activities. HASDC was created to benefit the Houston Airport System by seeking to increase air travel and air transport and trade activities through the Houston Airport System and the City. Under their contractual arrangement, HASDC pays Houston Airport System for all technical services that it provides. To date HASDC has organized a number of training sessions for airport executives from China and other foreign countries and is a participant in the consortium that is providing privatized operation for the existing airport and privatized development for the new international airport for Quito, Ecuador.

Houston Airport System is aware of growing interest in airport privatization projects throughout the world, although to a lesser extent within the United States. As mentioned in the "---Houston Airport System Capital Improvement Program," the Houston Airport System is considering a privatized third party arrangement for the enhancement of the central heating and cooling facilities at Intercontinental. Additional privatization projects may be proposed to Houston Airport System for its consideration in the future.

THE AIRLINES AND THE AIRLINE INDUSTRY

Certain of the certificated major domestic airlines (or their respective parent corporations) are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended, and thus must file reports and other information with the Securities and Exchange Commission (the "Commission"). Certain information, including financial information, as of particular dates, concerning the certificated major domestic airlines (or their respective parent corporations) is disclosed in such reports and statements filed with the Commission. Such reports and statements can be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, and at the Commission's regional offices, including the Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, IL 60661-2511 and 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036. Copies of such reports and statements can be obtained from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The Commission also maintains a web site at http://www.sec.gov containing reports, proxy and information statements and other information regarding registrants that file electronically with the Commission. The Commission undertakes no responsibility for and makes no representations (and the City, the City's Co-Financial Advisor and the Underwriters disclaim any responsibility) as to the accuracy or completeness of the content of such material contained on the world wide web as described in the preceding sentence, including but not limited to, updates of such information or links to other world wide web sites accessed through the aforementioned web site.) In addition, all major and certain other airlines are required to file periodic reports of financial and operating statistics with the United States Department of Transportation. Such reports can be inspected in the Office of Airline Statistics, Research and Special Programs Administration, United States Department of Transportation, 400 Seventh Street, S.W., Washington, D.C. 20590, and copies of such reports can be obtained from the U.S. Department of Transportation at prescribed rates.

Airlines owned by foreign governments or foreign corporations operating airlines (other than foreign airlines that have American Depository Receipts registered on a national exchange) are not required to file information with the Commission. Airlines owned by foreign governments, or foreign corporations operating airlines, file limited information only with the U.S. Department of Transportation.

INVESTMENT CONSIDERATIONS

Potential Effects of City Charter Revenue Limitations on Airport Revenues

For a discussion of the effect of certain City Charter tax and revenue limitations, voter-approved propositions, and the potential impact of ongoing litigation involving such limitations and propositions on the operation of the Houston Airport System, see "–City Charter Tax and Revenue Limitations."

Airlines Serving the Houston Airport System

Continental. During Fiscal Year 2006, Continental and its affiliate partners represented 86.3% of the passengers at Intercontinental and 71.9% of the passenger traffic for the full Houston Airport System. See Schedule 2–Airline Market Shares. In Fiscal Year 2006, Continental (including its commuter partner, ExpressJet) accounted for 48.2% of operating revenues of the Houston Airport System. For a discussion of the source of operating revenues for the Houston Airport System, and the term of Continental's use and lease agreement at Intercontinental, respectively, see "HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION–Source of Operating Revenues," and "HOUSTON AIRPORT SYSTEM AGREEMENTS–Continental Use and Lease Agreements and Terminal E Lease."

Southwest. Southwest has the second largest market share at the Houston Airport System. During Fiscal Year 2006, Southwest represented 88.0% of the passengers at Hobby and 14.9% of the passenger traffic for the Houston Airport System. See Schedule 2–Airline Market Shares. In Fiscal Year 2006, Southwest accounted for 7.9% of operating revenues of the HOUSTON AIRPORT SYSTEM. For a discussion of Southwest's expansion at Hobby, the source of operating revenues for the Houston Airport System, and the term of Southwest's use and lease agreement at Hobby, respectively, see "Houston Airport System Facilities–Hobby," "HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION–Source of Operating Revenues," and "HOUSTON AIRPORT SYSTEM AGREEMENTS–Hobby Use and Lease Agreements."

The City can make no representations with respect to the future level of activity of Continental or Southwest at the Houston Airport System, and no assurances can be given that Continental will continue to use Intercontinental as a system hub or that Southwest will continue to use Hobby as a system hub. In the event Continental or Southwest discontinue or reduce their hub operations at the Houston Airport System, their current level of activity may not be replaced by other carriers.

Information concerning Continental and Southwest may be found in their respective Commission filings at www.sec.gov. These filings provide comprehensive financial and operational and other information concerning Continental and Southwest, and prospective investors are encouraged to review such filings prior to making an investment decision. The City cannot undertake any responsibility for and makes no representations as to the accuracy or completeness of the content of information available from the Commission.

Changes in Federal Legislation

In February 1980, Congress passed what is commonly referred to as the "Wright Amendment," as a part of the International Air Transportation Competition Act of 1979. The Wright Amendment limited interstate commercial airline passenger services out of Love Field in the City of Dallas, Texas, a hub for Southwest, (i) to any interstate destinations in aircraft having a passenger capacity of 56 seats or less (the "Commuter Aircraft Exception"), or on charter flights not exceeding 10 per month, and (ii) to the four states adjacent to Texas in aircraft of any size, subject to certain restrictions on through-service or ticketing, and operational restrictions on the flight or aircraft serving any point outside such adjacent states. In 1997, Congress passed the so-called "Shelby Amendment." That legislation (i) expanded the adjacent-state rule of the Wright Amendment to add three states to the four states adjacent to Texas, and (ii) provided that an aircraft weighing not more than 300,000 pounds that is reconfigured to accommodate 56 or fewer passengers would be in compliance with the Commuter Aircraft Exception of the Wright Amendment, regardless of its destination. In 2005, Congress expanded the adjacent-state rule to include Missouri thus allowing non-stop flights from Love Field to a total of eight states. On October 13, 2006, President Bush signed into law legislation which (i) allows one-stop and through-service ticketing outside of the Wright Amendment's former restrictions, (ii) reduces Love Field's maximum gate capacity from 32 to 20 gates, and (iii) completely repeals the Wright Amendment in 2014. The impact on the Houston Airport System in 2014 cannot be predicted at this time.

General Factors Affecting Airline Activity at Houston Airport System

There are numerous factors that affect air traffic generally and, more specifically, air traffic at the Houston Airport System. Demand for air travel is influenced by factors such as population, levels of disposable income, the nature, level and concentration of industrial and commercial activity in the service area and the price of air travel. The price of air travel is, in turn, affected by the number of airlines serving a particular airport and a particular destination, the financial condition, cost structure and hubbing strategies of the airlines serving an airport, the willingness of competing airlines to enter into an airport market, the cost of operating at an airport, the price of fuel and any operating constraints (due to capacity, environmental concerns or other related factors) limiting the frequency or timing of airport traffic within the national system or at a particular airport.

The financial strength and stability of airlines serving the Houston Airport System are key determinants of future airline traffic. In addition, individual airline decisions regarding level of service, particularly hubbing activity, at the Houston Airport System will affect total enplanements. No assurance can be given as to the levels of aviation activity that will be achieved by the Houston Airport System. There can be no assurance that the Houston Airport System, despite a demonstrated level of airline service and operations, will continue to maintain such levels in the future. The continued presence of the airlines serving the Houston Airport System, and the levels at which that service will be provided, are a function of a variety of factors.

General Factors Affecting Air Carrier Revenues

The revenues of both the Houston Airport System and the airlines serving the Houston Airport System may be materially affected by many factors including, without limitation, the following:

Cost of Fuel. According to the Air Transportation Association, fuel is the second largest cost component of airline operations after labor and continues to be an important and uncertain determinate of an air carrier's operating economics. According to the Bureau of Transportation Statistics, airlines spent more than $34 billion on fuel during 2006, compared to the $32 billion spent in 2005 and more than double the amount spent in 2003. Historically, aviation fuel prices have been particularly sensitive to worldwide political instability. Economic expansion in emerging markets also contributes to higher aviation fuel prices. Significant and prolonged increases in the cost of aviation fuel have had and are likely to continue to have an adverse impact on the air transportation industry by increasing airline operating costs, hampering airline recovery plans and reducing airline profitability.

Threat of Terrorism. The terrorist attacks in the United States and other parts of the world, the conflicts in Iraq and Afghanistan and the increased threat of further terrorist attacks decreased passenger traffic levels commencing in 2001. Since FY 2005, the Houston Airport System has been above its pre-September 11, 2001 passenger traffic levels. The City cannot assess the threat of terrorism and the probability of another attack on American soil or against Americans traveling or American interests abroad. Should new attacks occur against the air transportation industry, the travel industry, cities, utilities, infrastructure, office buildings or manufacturing plants, the effect on travel demand could be substantial.

Declining demand; service and cost competition; mergers; high fixed costs; high capital requirements; the cost and availability of financing; technological changes; the cost and availability of employees; strikes and other employee disruptions; the maintenance and replacement requirements of aircraft; the availability of routes and slots at various airports; litigation liability; regulation by the federal government; environmental risks and regulations; noise abatement concerns and regulation; deregulation; federal and state bankruptcy and insolvency laws; and other risks also could negatively affect air carrier revenues. Many airlines, as a result of these and other factors, have operated at a loss in the past and several have filed for bankruptcy, ceased operations and/or have merged with other airlines.

Effect of Airline Bankruptcies

Certain airlines serving the Houston Airport System, including Delta Air Lines and Northwest Airlines, have filed for and remain under bankruptcy protection. US Airways and United Airlines have only recently emerged from bankruptcy. Additional bankruptcies, liquidations or reorganizations of other airlines could occur. The bankruptcy of an airline with significant operations at the Houston Airport System, such as Continental or Southwest, could have a material adverse effect on operations at the Airport, Airport Revenues, and the cost to the other airlines operating at the Houston Airport System.

Airline Lease Agreements. In the event of bankruptcy proceedings involving one or more of the airlines operating at the Houston Airport System, the debtor or its bankruptcy trustee must determine within a time period determined by the court whether to assume or reject the applicable airline use and lease agreement or other lease agreements. In the event of assumption, the debtor would be required to cure any prior defaults and to provide adequate assurance of future performances under the relevant agreements. Rejection of a lease or executory contract by any of such airlines would give rise to an unsecured claim of the City for damages, the amount of which in the case of a lease is limited by the Bankruptcy Code.

PFCs. Pursuant to 49 U.S.C. §40117 and the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (the "PFC Act"), the FAA has approved the City's application to require the airlines to collect and remit to the City a $3.00 PFC on each enplaning revenue passenger at Hobby as further discussed in "Houston Airport System Capital Improvement Program–Passenger Facility Charge."

The PFC Act provides that PFCs collected by the airlines constitute a trust fund held for the beneficial interest of the eligible agency (i.e., the City) imposing the PFCs, except for any handling fee or retention of interest collected on unremitted proceeds. In addition, federal regulations require airlines to account for PFC collections separately and to disclose the existence and amount of funds regarded as trust funds for financial statements. However, the airlines are permitted to commingle PFC collections with other revenues and are also entitled to retain interest earned on PFC collections until such PFC collections are remitted. In the event of a bankruptcy, the PFC Act, as amended in December 2003, provides that (1) PFCs are and remain trust funds, (2) the airline in bankruptcy may not grant to any third party any security or other interest in PFC revenue, and (3) the airline in bankruptcy must segregate in a separate account PFC revenue equal to its average monthly PFC liability as well as postpetition actual PFCs. Despite these enhanced statutory protections, it is unclear whether the City would be able to recover the full amount of PFC trust funds collected or accrued with respect to an airline in the event of a liquidation or cessation of business. The City also cannot predict whether an airline operating at Hobby Airport that files for bankruptcy would have properly accounted for PFCs owed to the City or whether the bankruptcy estate would have sufficient moneys to pay the City in full for PFCs owed by such airline. The PFCs are not pledged to the payment of the Bonds. For a discussion of the treatment of PFC Revenues under the Ordinance, see "APPENDIX H."

Uncertainties of the Airline Industry

Since the economic deregulation of the airline industry in 1978, the industry has undergone significant changes including the number of airline mergers, acquisitions, bankruptcies and closures. In addition, the financial results of the airline industry have been subject to substantial volatility since deregulation. The airline industry is highly competitive and susceptible to price discounting. Carriers have used discount fares to stimulate traffic during periods of slack demand, to generate cash flow and to increase market share. Airline profit levels are highly sensitive to changes in fuel costs, fare levels and passenger demand. Passenger demand and fare levels have in the past been influenced by, among other things, the general state of the economy (both internationally and domestically), international events, airline capacity and pricing actions taken by carriers. The continuing influence of these factors and their impact on the airline industry may result in further bankruptcy filings and major restructurings by airlines.

Also in recent years, major U.S. airlines, including Continental, have been the subject of published reports concerning consolidation and merger activity in the airline industry. At this time, the City cannot predict the potential impact of any such matters on the business, financial condition, and results of operation at the Houston Airport System.

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THE CITY OF HOUSTON AND CITY FINANCIAL INFORMATION

The City of Houston

The City has a mayor-council form of government in which the Mayor and the 14-member City Council serve as the legislative body. Nine council members are elected by district and five council members are elected at-large. The Mayor, all members of the City Council and the City Controller are elected for two-year terms. The present term of office for all elected officials expires in January 2008. The City Charter limits the terms of office for all elected city officials to three consecutive two-year terms.

Although the City is a home-rule city under the Texas Constitution, it may not adopt ordinances or charter provisions inconsistent with Texas law. Under the Texas Constitution, the City Charter may be amended not more than once every two years at an election held for that purpose, which may be called by the City Council or upon petition of 20,000 of the City's registered voters. The last City Charter amendments were adopted on November 7, 2006. See "DEBT SERVICE REQUIREMENTS OF HOUSTON AIRPORT SYSTEM BONDS–City Charter Limitations."

The Texas Legislature concluded its regular session on May 28, 2007. The Governor could elect to call one or more special sessions for the purpose of considering any of the proposals that did not pass during the regular session or to consider new proposals. The Texas Legislature may enact legislation that (i) materially increases the costs and expenditures of the City or (ii) reduces the ability of the City to collect ad valorem taxes or other revenues described herein. Under the Texas and United States Constitutions, the Texas Legislature may not, however, enact legislation that impairs the City's ability to pay principal of and interest on its indebtedness.

City Interest Rate Swap Policy

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

The City has entered into Swap agreements in connection with its Public Improvement Bonds and Combined Utility System Revenue Bonds. To date, the City has not entered into any Swap agreements in connection with the Bonds or other Houston Airport System Bonds.

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

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

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

Investment of Moneys

The City maintains an investment strategy that emphasizes, in order of priority, safety, liquidity and return on investment, as embodied in its investment policy (the "Policy"). The City does not invest in inverse floaters, or interest-only or principal-only mortgage-backed securities. The Policy provides, among other things, that (1) the Investment Manager (as defined in the Policy) shall submit quarterly investment reports to City Council and (2) the Policy shall be reviewed annually by City Council. For a further discussion of the Houston Airport System Fund investments as of June 30, 2006, see Note 1.F.1 and Note 3.B of the Notes to the Financial Statements as set forth in APPENDIX B.

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

The Ordinance provides that all interest and income derived from the deposit and investment of amounts held in all Funds will be transferred or credited monthly to the Revenue Fund and shall constitute Gross Revenues of the Houston Airport System (unless specifically excluded from the definition of Gross Revenues), except as follows: (1) all interest and income derived from deposits and investments credited to the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund and the Operation and Maintenance Reserve Fund will remain in such funds to the extent necessary to accumulate the Reserve Fund Requirements or other required balance therein; and (2) all interest and income derived from deposits and investments held in any construction fund, including amounts held therein as capitalized interest, created by any ordinance authorizing the issuance of Houston Airport System Bonds or Senior Lien Bonds will remain in such construction fund for disposition in the manner provided in the applicable ordinance.

Health Care Benefits for Retired Employees

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

The City has taken steps to assess the current and future financial impact of its unfunded OPEB liabilities, and is reviewing the appropriate policies to address and manage any such liabilities. In preparation for the implementation of GASB 45, the City commissioned a preliminary actuarial study for use as a planning tool in order to assist the City in estimating the actuarial costs of other post-employment benefits and formulating a GASB 45 implementation plan. The preliminary actuarial study indicated that as of June 30, 2006 the City's total actuarial accrued liability (AAL) for benefits earned by the City's municipal employees and classified police officers and firefighters was approximately $3.2 billion, and the annually required contribution that would be required to pay the normal costs of the benefits and to effect a level amortization of the AAL over a 30 year period would have been approximately $326 million. The City plans to commission an official actuarial report dated as of July 1, 2007 for adoption during Fiscal Year 2008.

Similar to many issuers, the City's current practice has been to fund the cost of OPEB on an annual pay-as-you-go basis and to account for OPEB costs as a current operating expense in the Fiscal Year in which the OPEB cost is paid. The Houston Airport System Fund paid approximately $1.4 million for retiree health insurance premiums in Fiscal Year 2006 or 2.8% of the City's total payments of $50.8 million. The Houston Airport System Fund's payment for Fiscal Year 2007 is estimated to be $1.6 million. To date, the City has not accumulated assets to offset future benefit costs.

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

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

See also Appendix B, particularly Note 8 of the Houston Airport System Fund's audited financial statements for Fiscal Year 2006, which includes information relating to retiree health care premiums paid by the City in Fiscal Year 2006, as well as information relating to health and long-term disability benefits.

Employee Pension Funds

General Overview

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

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

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

Pension System Funding. The City budgets for its contributions to the Pension Systems by allocating the cost between its General Fund and Enterprise Funds, including the Houston Airport System, based upon the nature of the employment of the covered employees. For Fiscal Year 2007, the General Fund was responsible for approximately 54% ($39 million) of the City's $72 million contribution to the Municipal System and the Houston Airport System was responsible for 12.8% ($9.2 million), with the remainder being split by the City's remaining Enterprise Funds. See "—Houston Airport System Contributions to the Municipal System." The City's General Fund covered substantially all of the City's contributions to the Police System and the Firefighter Fund in Fiscal Year 2007. See the Houston Airport System's audited financial statements for Fiscal Year 2006, including particularly Note 7 for a discussion of the City's Pension Systems.

Funding Synopsis. Since 2001, the Municipal System has experienced rapidly increasing UAAL and attendant increases in future actuarially determined contributions. As a result, the City has taken a number of actions to improve the financial condition of the Municipal System, including (i) conducting a successful election to opt-out of an amendment to the Texas Constitution, which prohibits (unless the jurisdiction "opts out") a reduction in or other impairment of the retirement or death benefits provided by the public retirement systems of political subdivisions that a member of such a system has "accrued," and (ii) entering into a "meet and confer" agreement with HMEPS 2005 (the "2005 HMEPS Agreement") and amending the 2005 HMEPS Agreement in 2007 (the "2007 HMEPS Agreement," and together with the 2005 HMEPS Agreement, the "HMEPS Agreements") regarding benefit levels for current and future employees and employee and certain City contributions. See "—Municipal System Overview and HMEPS Agreement—Meet and Confer Agreements" and "— Funding Status", below, for a discussion of the recently approved 2007 HMEPS Agreement, which affects city contributions and employee benefits for Fiscal Years 2008-2011, and the status of the City's current contributions to the actuarially determined amounts due.

Houston Airport System's Contributions to the Municipal System

The City budgets for its contributions to the Municipal System by allocating the cost among its General Fund and various Enterprise Funds based upon the percentage of total payroll paid by the funds. For Fiscal Year 2007, municipal employees of the Houston Airport System comprise approximately 13.3% of the total civilian workforce payroll of the

City, and accordingly, the Houston Airport System is responsible for approximately this percentage of the pension contributions for the Municipal System. To the extent the share of budgeted payroll for municipal employees of the Houston Airport System changes in the future, the allocable percentage of the budgeted contributions by the Houston Airport System to the Municipal System will also change.

As a result of the 2005 HMEPS Agreement, the Houston Airport System made payments to the Municipal System of $8.3 million in Fiscal Year 2006, and made payments of $9.2 million in Fiscal Year 2007. The City and HMEPS recently approved the 2007 HMEPS Agreement, which will govern the City's funding commitment to the Municipal System for Fiscal Years 2008 through 2011. The 2007 HMEPS Agreement requires the City to make a contribution of approximately $75 million in Fiscal Year 2008. The Airport System will be responsible for approximately $8.8 million of such contribution. See "—Municipal System Overview and HMEPS Agreements—Meet and Confer Agreements."

In addition to the cash contributions made by the City, the City has issued its Taxable General Obligation Pension Bonds, Series 2005 (the "Series 2005 Pension Bonds"), its Taxable Pension Obligation Bonds, Series 2006A (the "Series 2006A Pension Bonds"), and its Taxable Pension Obligation Bonds, Series 2007A (the "Series 2007A Pension Bonds") to meet its obligations under its 2005 Meet and Confer Agreement. The City paid $33 million of the proceeds of each series of bonds to the Municipal System. Although these bonds are secured by a pledge of ad valorem tax revenues, the Houston Airport System is responsible for repaying its pro-rata share of debt service on $2.0 million of the Series 2005 Pension Bonds issued in Fiscal Year 2005 for its benefit. This debt service payment is in addition to the Houston Airport System's annual contribution to HMEPS based on the current payroll of active employees. The Houston Airport System has no responsibility for debt service on the Series 2006A Pension Bonds or the Series 2007A Pension Bonds because it is fully paying its share of pension contributions as determined by "meet and confer" agreements from operating revenues. The Houston Airport System is also currently responsible for 12% of the debt service on a $300 million collateralized pension obligation note delivered by the City to the Municipal System. See "Municipal System Overview and HMEPS Agreements" for a description of the $300 million collateralized pension obligation note.

Municipal System Overview and HMEPS Agreements

General. The governance structure of the Municipal System was established by the HMEPS Statute and the HMEPS Agreements. The Municipal System is overseen by a board of trustees on which representatives of the City comprise a minority of the membership, with the majority of the members being active or retired members of the Municipal Systems and their appointees. The active and retired members of the board of trustees of HMEPS have a personal interest in the pension plan administered by the board of trustees. All trustees of the Pension System take an oath to "diligently and honestly administer" the Pension System, and each trustee is counseled on his/her fiduciary responsibilities. Trustees appointed by the City are counseled that their fiduciary duties to the Pension System take precedence over the interests of the agency or official that appointed them to the board. No legal challenges have arisen as a result of potential conflicts of interest.

The Municipal System provides benefits to most municipal employees other than classified police officers and firefighters. It is structured as a contributory defined benefits pension program for employees hired since 1999 ("Plan A"). Employees hired prior to 1999 had a choice between Plan A and a non-contributory plan ("Plan B"). The 2001 Texas Legislature increased benefit levels for both Plan A and Plan B, primarily by increasing the benefit accrual levels and the maximum pension amount. These benefit changes were supported jointly by the City and representatives of the Municipal System based on an actuarial cost analysis performed by the Municipal System's actuary, which showed that the City contribution to the Municipal System as a percentage of payroll could be expected to rise to approximately 14.7% as a result of the changes. The 2001 benefit changes in combination with lower than expected investment performance resulted in actuarially determined net contributions of 52.8% of payroll. In the three years following the 2001 benefits increase, the Municipal System experienced a rapid increase in UAAL in an amount that greatly exceeded the actuarial projection made at the time of the benefit increases. As a result, the City and the Municipal System entered into the 2005 HMEPS Agreement, described below, which effectively reduced the City's actuarially determined contribution amount to its current level of approximately 24% of payroll.

HMEPS Agreements

2005 HMEPS Agreement. In 2004, the Board of Trustees of the Municipal System approved, and City Council ratified, the funding plan and benefit changes referred to herein as the 2005 HMEPS Agreement. The 2005 HMEPS Agreement was effective as of September 15, 2004, and will remain in effect until December 31, 2009. The 2005 HMEPS Agreement, as amended, has three elements: (1) a funding commitment by the City for Fiscal Years 2005, 2006, and 2007 to include cash, the issuance of Pension Obligations and the contribution of certain City assets; (2) a required increase in the employee's contribution; and (3) benefit level reductions. ***Notwithstanding the changes effected by the 2005 HMEPS***

Agreement, the City's funding commitment, while substantially greater than normal cost, was less than the City's projections of actuarially determined contributions. Unless offset by investment performance or other factors, this funding deficiency will result in an increased UAAL with attendant increases in future actuarially determined contributions unless additional steps are taken to increase funding levels or modify benefits. See "2007 Meet and Confer Agreement" for a discussion of additional changes to the City's contribution levels and employee benefits.

The following is a summary of certain terms of the 2005 HMEPS Agreement pertaining to the City's funding commitment and employee contributions:

City Funding Commitment. Under the HMEPS Agreement, the City made budgeted contributions of \$33 million, \$36 million, and \$39 million in Fiscal Years 2005, 2006, and 2007, respectively, and has issued Pension Obligations in each of those three Fiscal Years such that the net proceeds of each such issue is equal to \$33 million, for a total three-year funding commitment by the City from these sources of \$207 million. The issuance of Pension Obligations in Fiscal Years 2005, 2006, and 2007 in lieu of using cash will result in an increase in the City's tax-supported bond indebtedness in order to achieve a reduction in UAAL.

In addition to the above contributions, in the HMEPS Agreement the City delivered to the Municipal System a collateralized note in the amount of \$300 million maturing on December 1, 2033 (the "Collateralized Note"). The Collateralized Note contains interest deferral provisions and was issued in conjunction with two deferred interest certificates, (1) a collateralized deferred interest certificate and (2) an uncollateralized deferred interest certificate, which provide the City some budgetary flexibility. The Collateralized Note and its related deferred interest certificates were issued pursuant to Chapter 107, Texas Local Government Code, and constitute general obligations of the City. The Collateralized Note was delivered by the City to the Municipal System on November 10, 2004, and is now considered an asset of the Municipal System for actuarial valuation purposes. The City may, at its sole option, defer interest payments on the Collateralized Note or the deferred interest certificates and allocate such deferred interest to the deferred interest certificates. To date, the City has deferred \$31.2 million of interest payments. The Houston Airport System has paid interest currently on its share of the Collateralized Note; none of the deferred amounts are attributable to the Houston Airport System.

A portion of the principal and interest on the Collateralized Note will be paid by the enterprise funds and special revenue funds that employ participants in HMEPS. The Houston Airport System is currently contributing 11.6% of the debt service on the Collateralized Note.

Employee Contribution. Beginning January 1, 2005, and continuing throughout the term of the HMEPS Agreement, City employees participating in the contributory groups contribute 5%, rather than the prior 4%, of base salary.

2007 Meet and Confer Agreement. In an effort to further reduce the UAAL of the Municipal System and add more certainty with respect to the size of the City's annual contribution to the Municipal System, HMEPS and the City have entered into the 2007 HMEPS Agreement, which will govern the City's funding commitment to the Municipal System for Fiscal Years 2008 through 2011. Under the terms of the 2007 HMEPS Agreement, the City would make contributions to the Municipal System of \$75 million in Fiscal Year 2008, \$78.5 million in Fiscal Year 2009, \$83.5 million in Fiscal Year 2010, and \$88.5 million in Fiscal Year 2011. The agreement will also switch employees hired after January 1, 2008 to a non-contributory defined benefits plan and reset the actuarial value of the Municipal System's assets as of July 1, 2007 to match the market value of the Municipal System's assets as of that date in order to fully recognize positive investment performance. The City believes that the changes made pursuant to the agreement will have the effect of reducing the UAAL of the Municipal System in the near term, and, depending on a variety of factors, including the rate of return, investment performance and future contributions by the City, there may be a further decline in the UAAL over a longer period of time.

Funding Status. Except as described in this next paragraph, the City has not made contributions to the Municipal System in the actuarially determined amounts since Fiscal Year 2003 (although such contributions have been legally sufficient under the HMEPS Statute or "meet and confer" agreements). See "–Schedule 8: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability" for additional results and trends.

In Fiscal Year 2005, the City contributed the \$300 million Collateralized Note to the Municipal System, however, such contribution is not considered a contribution for accounting purposes by the City's auditors because under GASB 27, such contribution did not reduce the City's net pension obligation as reported in the City's financial statements, but it has been recognized as a contribution by the Municipal System's actuaries and has been applied to reduce the UAAL of the Municipal System.

The City's funding commitment, increased employee contributions and reduced benefits provided for in the HMEPS Agreements had the effect of lowering the UAAL from approximately $1.8 billion as of July 1, 2003 to approximately $1.03 billion as of July 1, 2006. Pursuant to the terms of the 2007 HMEPS Agreement, the City believes in the near term it will further reduce its UAAL, though the long term impact of the 2007 Meet and Confer Agreement on the UAAL of the Municipal System will depend on a variety of factors. See "—Municipal System Overview and HMEPS Agreements." The Houston Airport System is responsible for only a portion of the costs of the Municipal System. See "Houston Airport System's Contributions to the Municipal System" for a discussion of how the City allocates pension costs to the Houston Airport System. It is likely that additional increases in City or employee contributions and/or additional benefit decreases will become necessary upon the expiration of the HMEPS Agreement, but the types and degree of such changes will depend on investment performance and other factors. If the City's actual contributions remain less than the actuarially determined contributions, it is expected that HMEPS's UAAL and attendant actuarially determined contributions will continue to increase, perhaps substantially.

Schedule 8: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability.

(in millions)

	As of July 1[(a)]				
	2002	2003	2004	2005	2006
Actuarial Accrued Liability	$ 2,515	$ 3,278	$ 2,634	$ 2,725	$ 2,894
Actuarial Value of Plan Assets [(b)].............	$ 1,520	$ 1,510	$ 1,501	$ 1,778	$ 1,867
Unfunded Actuarial Accrued Liability	$ 996	$ 1,768	$ 1,133	$ 948	$ 1,027
Funded Ratio...	60%	46%	57%	65%	65%

(a) For further details, see the Houston Airport System Fund's financial statements for Fiscal Year 2006 presented in APPENDIX B, including particularly Note 7 and the section captioned "Required Pension System Supplementary Information."

(b) The actuarial value of plan assets is determined by the actuary for the Municipal System. The value represents a generally accepted method of recognizing market gains and losses (relative to the assumed rate of return) over a five-year period.

City Charter Tax and Revenue Limitations

General

In 2004, voters approved initiatives proposing to reduce, cap or otherwise limit ad valorem tax revenues or other revenues of the City. One initiative ("Proposition 1") was placed on the ballot by City Council in response to a citizen initiative ("Proposition 2") that was placed on the ballot as a result of a petition submitted by voters of the City. In an election held in November 2004, a majority of the voters voted for both Proposition 1 and Proposition 2, but Proposition 1 received more favorable votes than Proposition 2. Because of language contained in Proposition 1 and the City Charter, the City believes that Proposition 1 is effective and Proposition 2 is not. Certain supporters of Proposition 2 filed a lawsuit in State district court seeking a declaratory judgment that Proposition 2 is valid and enforceable (the "Proposition 2 Lawsuit"). See "–Proposition Litigation." In response to these tax and revenue limitations, the City held an election on November 7, 2006 at which the voters approved Proposition G, a City Charter amendment excluding enterprise fund revenues from the Proposition 2 revenue limitations, and Proposition H, a measure that would allow the City to collect additional general fund revenues for public safety. Proposition 1, Proposition 2, Proposition G, and Proposition H are collectively referred to herein as "the Propositions."

Description of the Propositions

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

Proposition 2. Proposition 2, if effective, would limit increases in the City's "combined revenues," which would include revenues of the general fund, special revenue funds and enterprise funds, excluding only grant monies and revenues from other governmental entities. Proposition 2 would require a 60% vote at a regular election to increase combined revenues over the combined revenues for the immediately preceding Fiscal Year, adjusted for the rates of change in the consumer price index (the "CPI") for the Houston area and the City's population. If the actual increase in the amounts of combined revenues for any given Fiscal Year is less than the allowable increase, then such reduced amount of combined revenues received by the City would be the baseline for the next Fiscal Year. If in any year the City's "combined revenues" were to exceed the amount allowed by Proposition 2, then the City would be required to deposit such excess in a taxpayer relief fund. If the balance in the taxpayer relief fund were to reach $10 million, then such amount is required to be refunded to taxpayers.

Proposition 2 includes a provision that states that the City shall honor its covenants with bondholders such that shortfalls in debt coverage, among other covenants, shall be made up from reductions in other expenditures.

Proposition G. Proposition G amends the City Charter to exclude revenues of the City's enterprise systems (e.g. Combined Utility System, Houston Airport System, and the Convention and Entertainment Facilities Department) from the types of revenues limited under the City Charter. Prior to the approval of Proposition G, Proposition 2 would not have differentiated between general fund revenues, which fund essential services, and enterprise fund revenues, such as landing fees and concession revenues attributable to the Houston Airport System, which fund operations of a particular enterprise system. As a general matter, enterprise fund revenues may only be spent on costs of the enterprise system. Accordingly, under Proposition 2, any increase in revenues attributable to an enterprise fund might have resulted in forced reductions in essential services or other general fund expenditures, such as police, fire, parks and libraries, in order to comply with the Proposition 2 revenue limitations. The adoption of Proposition G should significantly reduce or eliminate the possibility that an increase in revenues attributable to the City's enterprise funds could cause a reduction in essential City services.

Proposition H. Proposition H is a measure that allows the City to collect and spend $90 million of revenue for increased police, fire and emergency medical services and related communications and dispatch costs. Such amounts will be added to the amount of allowable revenues in Fiscal Year 2007 and will be used as part of the base revenue calculations in future years. The City believes that Proposition H will provide the City with additional flexibility in providing funding for public safety. See "—Proposition G and H Litigation" for a discussion of a lawsuit seeking to invalidate Proposition H.

Revenue Limitation Proposition Litigation

Proposition 2 Litigation. Certain supporters of Proposition 2 filed a lawsuit in State district court seeking a declaratory judgment that Proposition 2 is valid and enforceable. On January 9, 2006, the district court granted the plaintiffs' motion for summary judgment as to the declaratory judgment action, but did so without stating any legal or factual basis for such ruling. The City has appealed the ruling to the Court of Appeals. It is not known when the Court of Appeals will issue a ruling on the City's appeal, and the unsuccessful party in the Court of Appeals may file an appeal to the Texas Supreme Court. Vinson & Elkins L.L.P. is one of the law firms representing the City in this matter.

Proposition G and H Litigation. A State district court recently dismissed an action by a voter of the City that sought to invalidate Propositions G and H. The plaintiff claimed that Proposition G violated provisions of state law relating to the presentation of charter amendments to the voters and that Proposition H violated various provisions of state law relating to ballot proposition language. The plaintiff may appeal the ruling.

LITIGATION AND REGULATION

Houston Airport System Claims and Litigation

The City is aware of various pending claims and lawsuits associated with the operation of the Houston Airport System. These include, but are not limited to, certain personal injury claims, claims involving rents and charges and property disputes. The City intends to defend itself vigorously against these claims and lawsuits; however, no prediction of the City's liability with respect to the claims, or the final outcome of the lawsuits, can be made at this time. In the opinion of management of the Houston Airport System, it is improbable that the lawsuits now outstanding against the City that are associated with the operation of the Houston Airport System could become final in a time and manner so as to have a material adverse financial impact upon the operations of the City or the Houston Airport System.

Other Claims and Litigation Affecting the City

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

In the opinion of the City's administration, it is improbable that the lawsuits now outstanding against the City could become final in a time and manner so as to have a material adverse financial impact upon the City.

Environmental Regulation

The City is subject to the environmental regulations of the State and the United States. These laws and regulations are subject to change, and the City may be required to expend substantial funds to meet the requirements of such regulatory authorities. Failure to comply with these laws and regulations may result in the imposition of administrative, civil and criminal penalties.

Air Emissions Controls

Air quality control measures required by the United States Environmental Protection Agency (the "EPA") and the Texas Commission on Environmental Quality ("TCEQ") may curtail new industrial, commercial and residential development in Houston and adjacent areas. Under the Clean Air Act Amendments of 1990, the eight county Houston-Galveston Consolidated Metropolitan Statistical Area ("CMSA") has been designated by the EPA as a severe non-attainment area under the EPA's "one-hour" ozone standard, and as a moderate non-attainment area under the EPA's newer "eight-hour" ozone standard. Such areas are required to demonstrate progress in reducing ozone concentrations each year until compliance with EPA's one-hour and eight-hour standards is achieved, but such compliance must occur no later than June 15, 2010. To provide for annual reductions in ozone concentrations, the EPA and the TCEQ have imposed increasingly stringent limitations on emissions of volatile organic compounds ("VOV's") and nitrogen oxides ("NOx") from existing stationary sources of air emissions. In addition, any new source of significant air emissions, such as a new industrial plant, must provide for a net reduction of air emissions by arranging for other industries to reduce their emissions by 1.3 times the amount of pollutants proposed to be emitted by the new source. Even though existing air emissions controls, originally imposed in an effort to achieve compliance with the one-hour ozone standard, are quite stringent, studies have indicated that even more stringent air emissions controls will be necessary in order for the Houston-Galveston CMSA to achieve compliance with the new eight-hour ozone standard. On May 23, 2007, the TCEQ adopted a plan to impose additional controls on sources of air emissions in the Houston-Galveston CMSA that are intended to demonstrate progress in achieving compliance with the eight-hour ozone standard, and the TCEQ's plan is due to be submitted to the EPA for approval in June 2007. Due to the magnitude of air emissions reductions required as well as shortage of economically reasonable control options, the development of a successful air quality compliance plan has been and continues to be extremely challenging and will inevitably impact a wide cross-section of the business and residential community. If the Houston-Galveston CMSA fails to demonstrate progress in reducing ozone concentrations or fails to meet EPA's one-hour and eight-hour ozone standards by 2010, EPA may impose a moratorium on the awarding of federal highway construction grants and other federal grants for certain public works construction projects, as well as severe emissions offset requirements on new major sources of hydrocarbon emissions for which construction has not already commenced. Given the very significant reductions in air emissions that will be required over the next few years in order for the Houston-Galveston CMSA to achieve compliance with the eight-hour ozone standard and the difficulties inherent in replacing fleets of vehicles and other heavy equipment, such as locomotive engines, with new ultra low emission fleets, on June 15, 2007, the Governor of Texas requested that EPA "bump-up" the Houston-Galveston CMSA from a moderate to a severe non-attainment area with respect to the eight-hour ozone standard. If the Houston-Galveston CMSA is designated as a severe non-attainment area under the eight-hour ozone standard, the deadline for achieving compliance would be extended to June 15, 2019.

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

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

RATINGS

Standard & Poor's Ratings Services and Fitch Ratings, Inc. have assigned ratings of "AAA," and "AAA," respectively, to the Bonds, with the understanding that, upon delivery of the Bonds, the City will obtain municipal Bond Insurance Policy issued by Financial Guaranty Insurance Company with respect to the Bonds. Standard & Poor's and Fitch have assigned underlying ratings of "A+" and "A+" to the Bonds.

Such ratings reflect only the view of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041; Fitch, Inc., One State Street Plaza, New York, New York 10004. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds. The City and its Co-Financial Advisors will undertake no responsibility either to bring to the attention of the registered owners of the Bonds any proposed change in or withdrawal of such ratings or to oppose any such revision or withdrawal.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

The accuracy of the mathematical computations of (i) the adequacy of the maturing principal of and interest earned on the Escrowed Securities together with other available funds held in the Escrow Fund, to provide for the payment of the Refunded Bonds and the Refunded Notes; and (ii) the "yield" on the Escrowed Securities and on the Bonds, prepared by the Underwriters, will be verified by Grant Thornton LLP, a firm of independent certified public accountants.

These computations will be based upon information and assumptions supplied by the Underwriters on behalf of the City. Grant Thornton LLP has restricted its procedures to recalculating the computations provided by the Underwriters and has not evaluated or examined the assumptions or information used in the computations.

TAX MATTERS

Tax Exemption

In the opinion of Vinson & Elkins L.L.P. and Bates & Coleman, P.C., Co-Bond Counsel, assuming compliance with certain covenants and based on certain representations, (i) interest on the Bonds is excludable from gross income for federal income tax purposes under existing law, and (ii) interest on the Bonds is not subject to the alternative minimum tax on individuals and corporations, except as described below in the discussion regarding the adjusted current earnings adjustment for corporations.

The Code imposes a number of requirements that must be satisfied in order for interest on state or local obligations such as the Bonds, to be excludable from gross income for federal income tax purposes. These requirements include, among other things, limitations on the use of the bond-financed project, limitations on the use of bond proceeds, limitations on the investment of bond proceeds prior to expenditure, a requirement that excess arbitrage earned on the investment of bond proceeds be paid periodically to the United States, and a requirement that the issuer file an information report with the Internal Revenue Service. The City has covenanted in the Ordinance that they will comply with these requirements.

Co-Bond Counsel's opinion will assume continuing compliance with the covenants of the Ordinance pertaining to those sections of the Code that affect the exclusion from gross income of the interest on the Bonds for federal income tax purposes and, in addition, will rely on representations by the City, the Co-Financial Advisor and the Underwriters with respect to matters solely within the knowledge of the City, the Co-Financial Advisor and the Underwriters, respectively, which Co-Bond Counsel have not independently verified. If the City fails to comply with the covenants in the Ordinance or if the foregoing representations should be determined to be inaccurate or incomplete, interest on the Bonds could become includable in gross income from the date of original delivery of the Bonds, regardless of the date on which the event causing such includability occurs.

The Code also imposes a 20% alternative minimum tax on the "alternative minimum taxable income" of a corporation, if the amount of such alternative minimum tax is greater than the amount of the corporation's regular income tax. Generally, the alternative minimum taxable income of a corporation (other than any S corporation, regulated investment company, REIT, REMIC, or FASIT) also includes 75% of the amount by which its "adjusted current earnings" exceeds its other "alternative minimum taxable income." Because interest on all tax-exempt obligations, including the Series 2007B Bonds, is included in a corporation's "adjusted current earnings," ownership of the Series 2007B Bonds could subject a corporation to alternative minimum tax consequences.

Under the Code, taxpayers are required to report on their returns the amount of tax-exempt interest, such as interest on the Bonds, received or accrued during the year.

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

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

Additional Federal Income Tax Considerations for the Series 2007B Bonds

Collateral Tax Consequences

Prospective purchasers of the Bonds should be aware that the ownership of tax exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations and individuals otherwise qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the "branch profits tax" on their effectively connected earnings and profits, including tax exempt interest such as interest on the Bonds. These categories of prospective purchasers should consult their own tax advisors as to the applicability of these consequences. Prospective purchasers of the Bonds should also be aware that, under the Code, taxpayers are required to report on their returns the amount of tax-exempt interest, such as interest on the Bonds, received or accrued during the year.

Tax Accounting Treatment of Original Issue Premium

The issue price of certain of the Bonds may exceed the stated redemption price payable at maturity of such Bonds. Such Bonds (the "Premium Bonds") are considered for federal income tax purposes to have "bond premium" equal to the amount of such excess. The basis of a Premium Bond in the hands of an initial owner is reduced by the amount of such excess that is amortized during the period such initial owner holds such Premium Bond in determining gain or loss for federal income tax purposes. This reduction in basis will increase the amount of any gain or decrease the amount of any loss recognized for federal income tax purposes on the sale or other taxable disposition of a Premium Bond by the initial owner. No corresponding deduction is allowed for federal income tax purposes for the reduction in basis resulting from amortizable bond premium. The amount of bond premium on a Premium Bond that is amortizable each year (or shorter period in the event of a sale or disposition of a Premium Bond) is determined using the yield to maturity on the Premium Bond based on the initial offering price of such Bond.

The Federal income tax consequences of the purchase, ownership and redemption, sale or other disposition of Premium Bonds that are not purchased in the initial offering at the initial offering price may be determined according to rules that differ from those described above. All owners of Premium Bonds should consult their own tax advisors with respect to the determination for federal, state and local income tax purposes of amortized bond premium upon the redemption, sale or other disposition of a Premium Bond and with respect to the federal, state, local and foreign tax consequences of the purchase, ownership and sale, redemption or other disposition of such Premium Bonds.

Tax Accounting Treatment of Original Issue Discount Bonds

The issue price of all or a portion of the Bonds may be less than the stated redemption price payable at maturity of such Bonds (the "Original Issue Discount Bonds"). In such case, the difference between (i) the amount payable at the maturity of each Original Issue Discount Bond, and (ii) the initial offering price to the public of such Original Issue Discount Bond constitutes original issue discount with respect to such Original Issue Discount Bond in the hands of any owner who has purchased such Original Issue Discount Bond in the initial public offering of the Bonds. Generally, such initial owner is entitled to exclude from gross income (as defined in Section 61 of the Code) an amount of income with respect to such Original Issue Discount Bond equal to that portion of the amount of such original issue discount allocable to the period that such Original Issue Discount Bond continues to be owned by such owner. Because original issue discount is treated as interest for federal income tax purposes, the discussions regarding interest on the Bonds under the captions "TAX EXEMPTION" and "ADDITIONAL FEDERAL INCOME TAX CONSIDERATIONS–Collateral Tax Consequences" generally applies, and should be considered in connection with the discussion in this portion of the Official Statement.

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

The foregoing discussion assumes that (a) the Underwriters have purchased the Bonds for contemporaneous sale to the public and (b) all of the Original Issue Discount Bonds have been initially offered, and a substantial amount of each maturity thereof has been sold, to the general public in arm's-length transactions for a price (and with no other consideration being included) not more than the initial offering prices thereof stated on the cover page of this Official Statement. Neither the Issuer nor Co-Bond Counsel has made any investigation or offers any comfort that the Original Issue Discount Bonds will be offered and sold in accordance with such assumptions.

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

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

LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS

Section 1201.041 of the Public Securities Procedures Act (Chapter 1201, as amended, Texas Government Code) provides that the Bonds are negotiable instruments governed by Chapter 8, Texas Business and Commerce Code, legal and authorized investments for banks, savings banks, trust companies, building and loan associations, savings and loan associations, insurance companies, fiduciaries and trustees and for the sinking funds of cities, towns, villages, school districts and other political subdivisions or public agencies of the State of Texas. The Bonds also are eligible to secure deposits of any public funds of the State of Texas or any political subdivisions or public agency of the State of Texas and are lawful and sufficient security for the deposits to the extent of their market value.

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

CONTINUING DISCLOSURE

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

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's Airport System Fund in APPENDIX B and under the schedules listed in APPENDIX D. The City will update and provide this information within six months after the end of each fiscal year. The City will provide the updated information to each nationally recognized municipal securities information repository ("NRMSIR") and to any state information depository ("SID") that is designated by the State and approved by the staff of the Commission. See APPENDIX D relating to the City's obligations to update Schedule 8, which contains actuarial information related to the Pension System.

The City may provide updated information in full text or in such other form consistent with the Ordinance, or may incorporate by reference certain other publicly available documents, as permitted by Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements, if the City commissions an audit and it is completed by the required time. If audited financial statements are not provided by that time, the City will provide audited financial statements when and if they become available, but if such audited financial statements are unavailable, the City will provide such financial statements on an unaudited basis within the required time. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B or such other accounting principles as the City may be required to employ from time to time pursuant to state law or regulation.

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

Material Event Notices

The City will also provide timely notices of certain events to certain information vendors. The City will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell 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 or events affecting the tax-exempt status of the Bonds; (7) modifications to rights of holders of the Bonds; (8) Bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. In addition, the City will provide timely notice of any failure by the City to provide information, data, or financial statements in accordance with its agreement described above under "–Annual Reports." The City will provide each notice described in this paragraph to any SID and to either each NRMSIR or the Municipal Securities Rulemaking Board ("MSRB").

Availability of Information from NRMSIRs and SID

The City has agreed to provide the foregoing information only to NRMSIRs and any SID. The information will be available to holders of Bonds only if the holders comply with the procedures and pay the charges established by such information vendors or obtain the information through securities brokers who do so.

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

Limitations and Amendments

The City has agreed to update information and to provide notices of material events only as described above. The City has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition, or prospects or agreed to update any information that is provided, except as described above. The City makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell the 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 the Bonds may seek a writ of mandamus to compel the City to comply with its agreement.

The City may amend its continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the City, if the agreement, as amended, would have permitted an underwriter to purchase or sell the Bonds in the offering made hereby in compliance with the Rule and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or any person unaffiliated with the City (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the beneficial owners of the Bonds. The City may also amend or repeal the agreement if the Commission amends or repeals the applicable provisions of the Rule or a court of final jurisdiction determines that such provisions are invalid, and the City may amend the agreement in its discretion in any other circumstance or manner, but in either case only to the extent that its right to do so would not prevent the Underwriters from purchasing the Bonds in the offering described herein in compliance with the Rule. If the City amends its agreement, it must include with the next financial information and operating data provided in accordance with its agreement described above under " — Annual Reports" an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided. See APPENDIX D relating to the City's obligation to update Schedule 8, which contains actuarial information related to the Municipal System.

Compliance with Prior Undertakings

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

No Continuing Disclosure Undertakings by Airlines

No airline has made any agreement regarding the continuing disclosure of information for the benefit of the holders and beneficial owners of the Bonds. However, certain of the certificated major domestic airlines (or their respective parent corporations) are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended, and thus must file reports and other information with the Commission. See "THE AIRLINES AND THE AIRLINE INDUSTRY." In addition, pursuant to the Rule, certain airlines may have agreed to continuing disclosure undertakings in connection with the issuance and sale of obligations other than the Bonds. Continental entered into a continuing disclosure agreement in connection with the Series 1997 Special Facilities Bonds, Series 1998 Special Facilities Bonds and the Series 2001 Special Facilities Bonds (Terminal E Project). In those instances the airlines would have undertaken, in a written agreement or contract for the benefit of the holders of such obligations, to provide to various information repositories, including NRMSIRs and SIDs, certain annual financial information and operating data, including audited financial statements, and to provide notice to such repositories and the MSRB of certain specified material events. Such information is available to securities brokers and others who subscribe to receive the information from such repositories.

LEGAL PROCEEDINGS

The delivery of the Bonds is subject to the approving opinions of the Attorney General of the State of Texas and of Vinson & Elkins L.L.P. and Bates & Coleman, P.C., Co-Bond Counsel for the City, as to the validity of the issuance of the Bonds under the Constitution and laws of the State of Texas. The opinion of Co-Bond Counsel will be based upon an examination of a transcript of certain certified proceedings taken by the City incident to the issuance and authorization of the Bonds. A copy of the proposed opinion of Vinson & Elkins L.L.P. and Bates & Coleman, P.C., to be delivered in connection with the Bonds, is attached to this Official Statement as APPENDIX C and will be printed on the Bonds.

In their capacity as Co-Bond Counsel, Vinson & Elkins L.L.P., Houston, Texas and Bates & Coleman, P.C., Houston, Texas, have reviewed the statements and information contained in the Official Statement under the captions and sub-captions "THE BONDS," "CONTINUING DISCLOSURE OF INFORMATION" (except for the information under the sub-captions "Compliance With Prior Undertakings" and "No Continuing Disclosure Undertaking by Airlines" as to which no opinion is expressed), and "EXHIBIT H", and Co-Bond Counsel is of the opinion that the statements and information contained therein fairly and accurately reflect the provisions of the Ordinance; further, Co-Bond Counsel has reviewed the statements and information contained in the Official Statement under the captions and sub-captions "TAX MATTERS," "LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS," and "LEGAL PROCEEDINGS" and Co-Bond Counsel is of the opinion that the statements and information contained therein are correct as to matters of law.

Such firms have not, however, independently verified any of the factual information contained in this Official Statement nor have they conducted an investigation of the affairs of the City or the Houston Airport System for the purpose of passing upon the fairness, accuracy or completeness of this Official Statement. No person is entitled to rely upon such firms' limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the fairness, accuracy or completeness of any of the information contained herein. The fees of Vinson & Elkins L.L.P. and Bates & Coleman, P.C., for their services with respect to the Bonds are contingent upon the sale and delivery of the Bonds.

Certain matters will be passed upon by for the City by its Special Disclosure Co-Counsel, Fulbright & Jaworski L.L.P., Houston, Texas and Escamilla & Poneck, Inc., Houston, Texas. Certain other legal matters will be passed on for the Underwriters by their counsel, Winstead PC, Houston, Texas.

CO-FINANCIAL ADVISORS

First Southwest Company and Estrada Hinojosa & Company, Inc. have been retained by the City as Financial Advisors in connection with the issuance of the Bonds and, in such capacity, has assisted the City in the preparation of documents. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is not contingent upon the issuance and delivery of the Bonds.

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

FINANCIAL STATEMENTS

The Houston Airport System Fund financial statements of the City of Houston, Texas as of June 30, 2006 and 2005 and for the years then ended, included in this Official Statement in APPENDIX B, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report appearing in APPENDIX B.

UNDERWRITING

UBS Securities LLC, as representative and on behalf of all of the Underwriters (the "Representative"), has agreed to purchase the Bonds, subject to certain conditions, and has agreed to pay therefor a price of $306,160,935.28 (reflecting the par amount of the Bonds, plus a net premium of $8,902,741.40 and less an underwriting discount of $1,411,806.12.) The Representative, on behalf of the Underwriters, will be obligated to purchase all of the Bonds, if any of the Bonds are purchased.

FORWARD LOOKING STATEMENTS

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

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

GENERAL INFORMATION

All of the summaries of the statutes, ordinances and other related reports set forth herein are made subject to all of the provisions of such documents. The descriptions of the Bonds and the Ordinance herein do not purport to be complete and all such descriptions or references thereto contained in this Official Statement are qualified in their entirety by reference to the complete forms of the Bonds and of the 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 even approximate actual results.

Copies of the June 30, 2006 Comprehensive Annual Financial Report of the City of Houston, Texas are available to each of the prospective purchasers of the Bonds upon written request addressed to the office of the City Controller, P.O. Box 1562, Houston, Texas 77251. THE BONDS ARE, HOWEVER, PAYABLE SOLELY FROM NET REVENUES OF THE HOUSTON AIRPORT SYSTEM AND CERTAIN RESERVES ESTABLISHED PURSUANT TO THE ORDINANCE, AND NO IMPLICATION IS MADE THAT ANY OTHER REVENUES OR MONEY OF THE CITY ARE TO BE AVAILABLE FOR THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE BONDS. Copies of the Ordinance are available to each of the prospective purchasers of the Bonds upon written request to the Office of the City Attorney, 900 Bagby, 4th Floor, Houston, Texas 77002. This document was approved by the City Council of the City.

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APPENDIX A

SCHEDULE OF REFUNDED OBLIGATIONS

Refunded Notes

	Maturity Date	Interest Rate	Par Amount	
Commercial Paper	11/20/07	3.780%	$12,500,000	
Series A	11/21/07	3.830%	11,500,000	
	11/21/07	3.800%	5,000,000	
	11/20/07	3.760%	5,000,000	
	12/06/07	3.750%	9,000,000	*
			$43,000,000	

* Partial refunding of outstanding principal.

Refunded Bonds

		Maturity Date	Interest Rate	Par Amount	Call Date	Call Price
Series 1997	Serial	07/01/2012	5.125%	$ 1,825,000	10/17/2007	100
	Serial	07/01/2013	5.125%	1,920,000	10/17/2007	100
	Serial	07/01/2014	5.125%	2,015,000	10/17/2007	100
	Serial	07/01/2015	5.125%	2,120,000	10/17/2007	100
	Serial	07/01/2016	5.125%	2,225,000	10/17/2007	100
	Serial	07/01/2017	5.125%	2,335,000	10/17/2007	100
	Term	07/01/2022	5.125%	18,520,000	10/17/2007	100
Series 2000B	Serial	07/01/2018	5.500%	$ 4,485,000	07/01/2010	100
	Serial	07/01/2019	5.500%	5,585,000	07/01/2010	100
	Serial	07/01/2020	5.500%	5,885,000	07/01/2010	100
	Term	07/01/2028	5.700%	64,220,000	07/01/2010	100
	Term	07/01/2030	5.500%	144,550,000	07/01/2010	100
				$255,685,000		

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APPENDIX B

HOUSTON AIRPORT SYSTEM FUND FINANCIAL STATEMENT

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Airport System Fund

An Enterprise Fund of the
City of Houston, Texas

Comprehensive Annual Financial Report
Fiscal Year Ended June 30, 2006

HOUSTON AIRPORT SYSTEM

Prepared by Office of the City Controller
Annise D. Parker, City Controller

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Airport System Fund

An Enterprise Fund of the

City of Houston, Texas

Comprehensive Annual Financial Report

Fiscal Year Ended June 30, 2006

Prepared by:
Office of the City Controller

Annise D. Parker
City Controller

Rudy Garcia, CPA
Deputy City Controller

Cherri Laughlin
Houston Airport System

COMPREHENSIVE ANNUAL FINANCIAL REPORT
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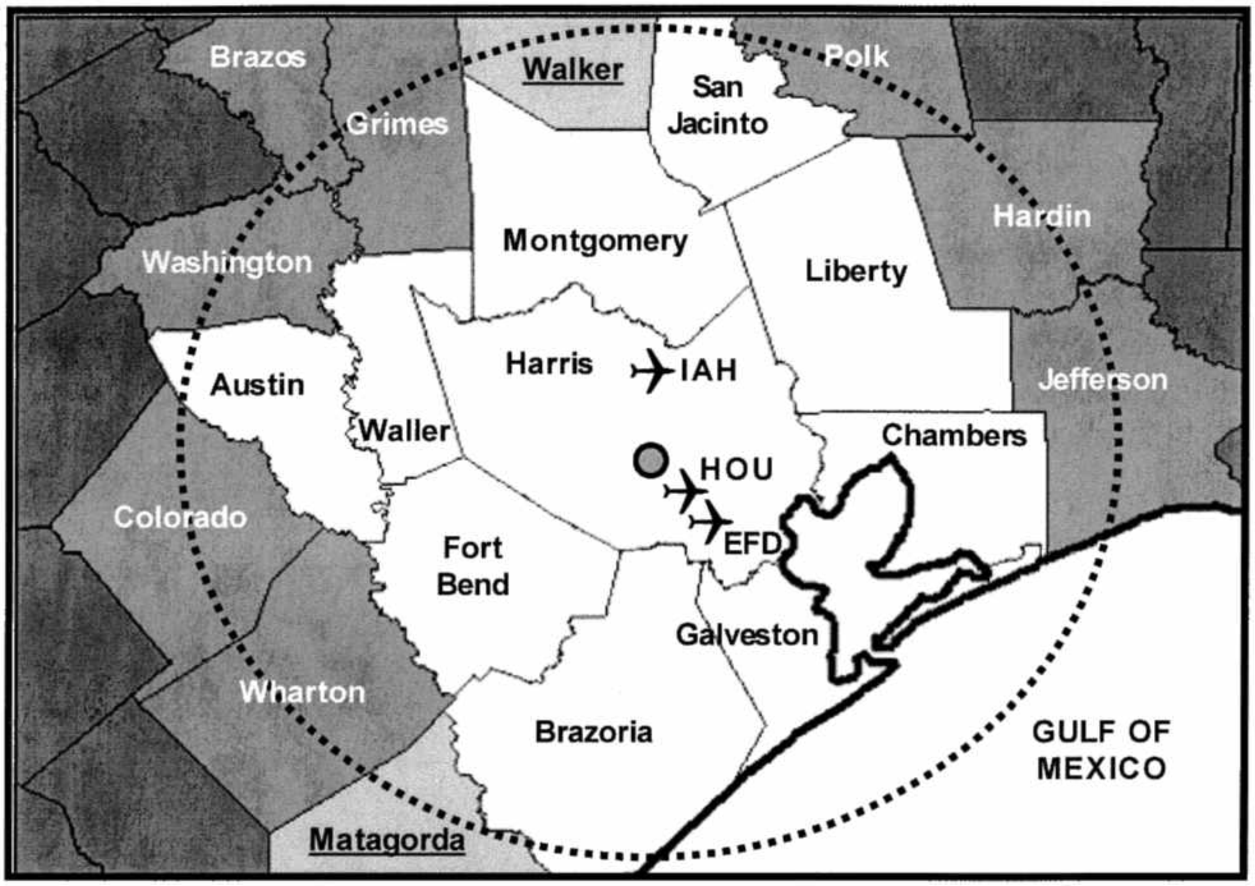
COMPREHENSIVE ANNUAL FINANCIAL REPORT

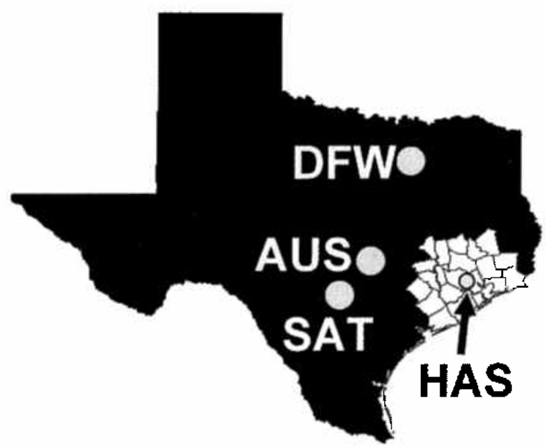
INTRODUCTORY SECTION

CITY OF HOUSTON
TEXAS

Houston Airport System Air Service Area



	Metropolitan Statistical Area (MSA) of **Houston – Sugar Land – Baytown, TX** includes 10 counties
	Consolidated Statistical Area (MSA) of **Houston – Baytown – Huntsville, TX** adds both Matagorda & Walker counties
	75-mile radius adds parts of an additional 8 counties



Source: U.S. Census Bureau

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Houston

Airport System Fund

Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

June 6, 2007

To the Citizens, Mayor and Members of the City Council of the City of Houston, Texas:

I am pleased to present you with the Comprehensive Annual Financial Report (CAFR) for the City of Houston, Texas, Airport System Fund (the Fund) for the fiscal year ended June 30, 2006, including the independent auditor's report. The Controller's Office and the Houston Airport System share responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the Fund.

The CAFR includes three sections: Introductory, Financial and Statistical. The Introductory Section includes this transmittal letter, the Fund's organizational chart, and a list of principal officials. The Financial Section includes Management's Discussion and Analysis and financial statements, as well as the independent auditors' report on the financial statements. The Statistical Section includes selected financial trends, revenue capacity, debt capacity, demographic and economic, and operating information, generally presented on a ten-year basis.

The Financial Section described above is prepared in accordance with Generally Accepted Accounting Principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB). The Management's Discussion and Analysis offers readers an overview and analysis of the financial activities of the Fund and should be read as an introduction to the financial statements. In addition, the Notes to the Financial Statements offer additional important information and are essential to a full understanding of this report.

The Reporting Entity and Its Services

The Houston Airport System, under the administrative control of the Mayor, manages and operates the Fund. The City Controller, as the chief financial officer of the City of Houston (the City), maintains the books of account, prepares financial statements, and, with the Mayor, co-signs all warrants, contracts, and orders for payment of any public funds or money relating to the department.

The Fund is an enterprise fund of the City and is included in the City's Comprehensive Annual Financial Report, which is a matter of public record. An enterprise fund is used to account for services provided to the general public on a continuing basis, with costs recovered primarily through user charges. The City's Airport System includes the following: George Bush Intercontinental Airport/Houston (Intercontinental), William P. Hobby Airport (Hobby) and Ellington Field. Continental Airlines, Inc. is the dominant air carrier operating at Intercontinental and Southwest Airlines, Inc. is the dominant air carrier operating at Hobby.

901 BAGBY, 8TH FLOOR • P.O. BOX 1562 • HOUSTON, TEXAS 77251-1562
PHONE: 713-247-1440 • FAX: 713-247-3181
e-mail: controllers@cityofhouston.net

Economic Conditions and Major Initiatives

Economic conditions

Houston is classified as a large air traffic hub by the Federal Aviation Administration (FAA). Based on total U.S. passenger traffic for calendar year 2005, Intercontinental and Hobby ranked ninth and forty-fourth, respectively, among U.S. airports. Intercontinental, which opened in 1969, is the City's dominant air carrier facility and is located approximately 22 miles north of the City's central business district on property comprising approximately 10,000 acres. Hobby is located approximately seven miles southeast of the central business district on approximately 1,500 acres. Ellington Field is situated approximately 15 miles southeast of the central business district on approximately 2,000 acres, a portion of which was conveyed to the City by the federal government on July 1, 1984.

The City of Houston is the nation's fourth most populous city and lies within the sixth largest metropolitan statistical area in the United States. Located on the coastal plain in southeast Texas, approximately 50 miles from the Gulf of Mexico, the City is a center for the energy, financial, medical, transportation, manufacturing, and retail industries. The service region for the Houston Airport System, the ten-county Houston-Sugar Land-Baytown Metropolitan Statistical Area, has a diverse economic base and is recognized as a major national and international energy, financial, medical, transportation, educational, and distribution center.

Key factors that will affect future airline traffic at the Houston Airport System include: (1) the growth in the population and economy of the service region, (2) national and international economic conditions, (3) airline economics and air fares, (4) the availability and price of aviation fuel, (5) airline service and route networks, (6) the capacity of the air traffic control system, and (7) the capacity of the airports themselves. As airport security has increased and terrorist concerns have eased, passenger traffic has increased in the last three fiscal years, and since Fiscal Year 2005 has exceeded the level that existed before September 11, 2001. Air freight has also increased in both of the last two fiscal years. Houston Airport System management cannot predict the operational and financial impact of these factors on the Airport System over the long term.

Capital Improvement Program

The Houston Airport System's Five-Year Capital Improvement Program for 2007 – 2011 is budgeted for $863,482,000, with half of the expenditures occurring during Fiscal Years 2007 and 2008. These improvements will be funded from airport revenues, airport revenue bonds, and the Federal Aviation Administration Airport Improvement Program grants.

Taxiway SD opened in April 2007 at George Bush Intercontinental Airport. The rehabilitation of Terminal C Concourses was completed. The next phase including rehabilitation of the terminal and parking garage as well as major improvements to the central plant system will begin construction in late 2007. Rehabilitation of Runway 9-27 will occur in Fiscal Year 2009. Design of the automated people mover extension from Terminal B to Terminal A began in October 2006. Master plan projects will be incorporated into the Capital Improvement Program as demand reaches trigger levels including additional terminal space, runways and roadway improvements. An environmental impact study starting in Fiscal Year 2007 will verify the need for runway improvements and terminal building improvements at Intercontinental.

Hobby's major project, the terminal expansion and rehabilitation, will continue over the next few years. The expansion of the Central Concourse for five additional gates will be complete in June 2007. The demolition of Concourses A and C will then occur so that the final aircraft parking areas associated with the Central Concourse can be completed. The entire 25 gates should be available by January 2008. Other major projects under construction include the new in-line baggage system. Rehabilitation of Runway 12R-30L will occur in Fiscal Year 2008 while the rehabilitation of Runway 4-22 is anticipated for Fiscal Year 2011. An environmental impact study, starting in Fiscal Year 2007, will verify the need for runway improvements and terminal access roadway improvements at Hobby.

Construction of Ellington Field's new taxilane began in October 2006. The taxilane which will open up airfield access to additional property is expected to be completed by July 2007. Taxiway H is also under construction.

Financial Information

Accounting systems and budgetary controls

The Fund's financial accounting system utilizes an accrual basis of accounting. Internal accounting controls are an integral part of the Fund's accounting system and are designed to provide reasonable, but not absolute, assurance that assets are safeguarded from unauthorized use or disposition.

The Fund controls current expenses at all division levels. The Houston Airport System's Deputy Directors are responsible for the expenses approved by the Division Managers reporting to them. In turn, Division Managers are responsible for budgetary items that are controllable at their organizational level. Budgetary control is maintained at the expenditure category (i.e., Personnel Services, Supplies, Other Services and Capital Outlay) through the encumbrance of estimated purchase amounts prior to the release of purchase orders or contracts to vendors. This is accomplished primarily through an automated encumbrance and accounts payable system.

The City Council approves the Fund's annual operations budget for current expenses. The Airport Fund as a whole is not budgeted. City Council authorizes capital project expenditures through individual appropriation ordinances based on a five-year Capital Improvement Plan that is proposed by the Mayor and the Houston Airport System Director and approved by City Council. City Council can legally appropriate only those amounts of money that the City Controller has previously certified.

Other Information

Independent Audit

An independent auditor audits the financial statements of the Airport System Fund each year. The firm of Deloitte & Touche LLP performed the Fiscal Year 2006, 2005, and 2004 audits. The Financial Section of this report includes the independent auditor's report on the basic financial statements.

The City is required to undergo an annual Single Audit in conformity with the provisions of the Single Audit Act, the U.S. Office of Management and Budget Circular A-133, "Audits of State, Local Governments and Non-profit Organizations," and the State of Texas Single Audit Circular. These audits are conducted simultaneously with the Fund's annual financial statement audit. Information related to these Single Audits, including the schedules of financial assistance, findings and recommendations, and auditor's reports on the internal control structure and compliance with applicable laws and regulations is included in separate Single Audit Reports.

Awards/Acknowledgments

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to City of Houston, Texas Airport System Fund for its comprehensive annual financial report for the fiscal year ended June 30, 2005. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

The preparation of this comprehensive annual financial report was made possible by the dedicated service of the Finance Division of the Houston Airport System, and the City Controller's Office.

Respectfully submitted,

Annise D. Parker
City Controller

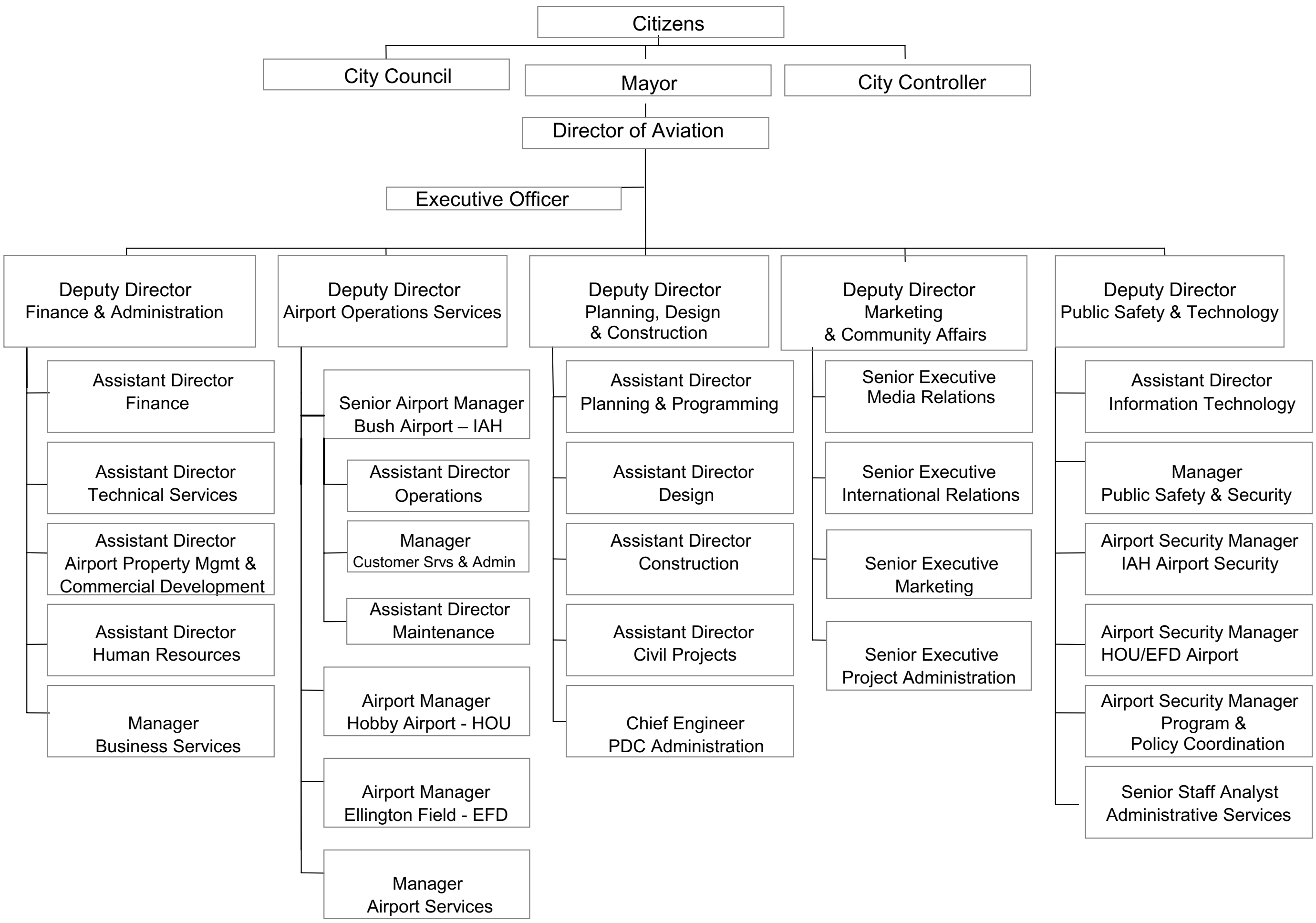
INTRODUCTORY SECTION
LIST OF PRINCIPAL OFFICIALS AT JUNE 30, 2006

ELECTED:

Mayor	Bill White
Controller	Annise D. Parker
Councilmember, At-Large, Position 1	Peter Brown
Councilmember, At-Large, Position 2	Sue Lovell
Councilmember, At-Large, Position 3	Shelley Sekula-Gibbs, MD
Councilmember, At-Large, Position 4	Ronald C. Green
Councilmember, At-Large, Position 5	Michael Berry
Councilmember, District A	Toni Lawrence
Councilmember, District B	Jarvis Johnson
Councilmember, District C	Anne Clutterbuck
Councilmember, District D	Ada Edwards
Councilmember, District E	Addie Wiseman
Councilmember, District F	M.J. Khan
Councilmember, District G	Pam Holm
Councilmember, District H	Adrian Garcia
Councilmember, District I	Carol Alvarado

DEPARTMENT OF AVIATION:

Director of Aviation	Richard M. Vacar, AAE
Deputy Director, Public Security and Technology	Mark V. Mancuso
Deputy Director, Finance and Administration	Sara S. Culbreth, CPA
Deputy Director, Marketing, Communications, and Community Affairs	Luis Perez
Deputy Director, Airport Operations Services	Thomas B. Bartlett
Deputy Director, Planning, Design and Construction	Eric R. Potts
Assistant Director, Finance	David K. Arthur, CPA


Citizens
City Council
Mayor
City Controller
Director of Aviation
Executive Officer
Deputy Director Finance & Administration
Deputy Director Airport Operations Services
Deputy Director Planning, Design & Construction
Deputy Director Marketing & Community Affairs
Deputy Director Public Safety & Technology
Assistant Director Finance
Assistant Director Technical Services
Assistant Director Airport Property Mgmt & Commercial Development
Assistant Director Human Resources
Manager Business Services
Senior Airport Manager Bush Airport – IAH
Assistant Director Operations
Manager Customer Srvs & Admin
Assistant Director Maintenance
Airport Manager Hobby Airport - HOU
Airport Manager Ellington Field - EFD
Manager Airport Services
Assistant Director Planning & Programming
Assistant Director Design
Assistant Director Construction
Assistant Director Civil Projects
Chief Engineer PDC Administration
Senior Executive Media Relations
Senior Executive International Relations
Senior Executive Marketing
Senior Executive Project Administration
Assistant Director Information Technology
Manager Public Safety & Security
Airport Security Manager IAH Airport Security
Airport Security Manager HOU/EFD Airport
Airport Security Manager Program & Policy Coordination
Senior Staff Analyst Administrative Services

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FINANCIAL SECTION

CITY OF HOUSTON

TEXAS

Deloitte.

Deloitte & Touche LLP
Suite 2300
333 Clay Street
Houston, TX 77002-4196
USA

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

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of net assets of the Airport System Fund (the "Fund") as of June 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the management of the City of Houston, Texas (the "City"). Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1 to the financial statements, the respective financial statements referred to above present only the Airport System Fund and do not purport to, and do not present fairly the financial position and results of operations of the City of Houston, Texas in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2006 and 2005, and its change in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis and pension system supplementary information are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of City's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Fund's basic financial statements. The introductory and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. This supplementary information is the responsibility of the City's management. The introductory section and statistical section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Deloitte & Touche LLP

June 6, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

As management of the Airport System Fund, we offer readers of the Airport System Fund's financial statements this narrative overview and analysis of the financial activities of the Airport System Fund for the fiscal year ended June 30, 2006. Please read this in conjunction with the financial statements and the notes to the financial statements, which follow this section. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights

- The Airport System Fund's net assets increased by $65.3 million or 6.1% during the year.

- Operating income increased by $33.4 million or 140.6%, due to an increase in operating revenue of $40.2 million or 11.4%. The increase in revenues is due in part to a 6.3% increase in passenger volume over the previous year. The increase in revenue is also a result of increases in terminal space rates, due to a full year's revenue associated with the international facilities and people mover system.

- Interest revenue increased by $3.5 million or 23.6% despite an unrealized decrease of $4.0 million in the fair value of the Fund's investments, compared to an unrealized increase of $0.4 million in the previous fiscal year.

- Operating expenses increased by $6.8 million or 2.1%. Depreciation expense increased $28.3 million or 26.7%. Maintenance and operating expenses decreased $21.5 million or 9.6% due primarily to a one-time increase in pension of $34.8 million in FY 2005.

- The Fund had a net loss before contributions of $18.8 million, compared to a net loss before contributions of $32.9 million in fiscal year 2005.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Airport System Fund's financial statements. The Airport System Fund's financial statements consist of two components: the financial statements and the notes to the financial statements. The notes are essential to a full understanding of this report.

A fund is a group of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. An enterprise fund is used to account for a business-like activity within a government. The Airport System Fund is an enterprise fund of the City of Houston. The Houston Airport System, consisting of George Bush Intercontinental Airport/Houston (Intercontinental), William P. Hobby Airport (Hobby), and Ellington Field, is managed and operated as a department of the City. The Airport System Fund is also included in the City of Houston's Comprehensive Annual Financial Report (CAFR).

The statement of net assets presents information on all the Fund's assets and liabilities, with the difference between the two reported as net assets. Increases and decreases in net assets from year to year may serve as a useful indicator of whether the financial position of the Airport System Fund is improving or deteriorating.

The statement of revenues, expenses and changes in net assets presents information showing how the Fund'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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The statement of cash flows reports how much cash was provided by or used for the Fund's operations, investing activities, and acquisition or retirement of capital assets.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

In addition to the financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City of Houston's progress in funding its obligation to provide pension benefits to its employees.

Net Assets

Total net assets at June 30, 2006 were $1,134.2 million, a 6.1% increase from June 30, 2005. Total net assets at June 30, 2005 were $1,068.9 million, a 3.0% increase from June 30, 2004.

NET ASSETS
JUNE 30, 2006, JUNE 30, 2005, and JUNE 30, 2004
(in thousands)

	June 30, 2006	June 30, 2005	June 30, 2004
Current assets	$ 680,658	$ 653,846	$ 766,540
Noncurrent assets	2,838,080	2,834,829	2,607,800
Total assets	3,518,738	3,488,675	3,374,340
Current liabilities	125,365	143,057	177,934
Long term liabilities	2,259,157	2,276,699	2,158,609
Total liabilities	2,384,522	2,419,756	2,336,543
Net assets invested in capital assets, net of related debt	688,569	695,039	668,742
Restricted net assets	445,647	373,880	369,055
Unrestricted net assets	-	-	-
Total net assets	$ 1,134,216	$ 1,068,919	$ 1,037,797

The largest portion of the Fund's total net assets (60.7% in fiscal year 2006) reflects net assets invested in capital assets (e.g., land, buildings, runways, equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Fund uses these capital assets to operate the airports; consequently, these assets are not available for future spending. Although the Fund'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 airport revenue and other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Fund's net assets (39.3% in fiscal year 2006) represents resources that are subject to external restrictions on how they may be used. Most of these restrictions are due to covenants made to the holders of the Airport System Fund's revenue bonds within ordinances passed by City Council.

Changes in Net Assets

From July 1, 2005 to June 30, 2006, net assets of the Airport System Fund increased by $65.3 million or 6.1%. From July 1, 2004 to June 30, 2005, net assets increased by $31.1 million or 3.0%.

CHANGES IN NET ASSETS
JUNE 30, 2006, JUNE 30, 2005, AND JUNE 30, 2004
(in thousands)

	June 30, 2006	June 30, 2005	June 30, 2004
Operating revenue:			
Landing area fees	$ 101,758	$ 102,072	$ 57,011
Rentals, building and ground	179,951	151,417	115,777
Parking and concessions	108,884	97,286	94,537
Other	3,268	2,866	3,088
Total operating revenues	393,861	353,641	270,413
Nonoperating revenue:			
Interest on investments	18,507	14,968	5,967
Arbitrage rebate recovery	160	1,137	4,323
Other nonoperating	56	4,295	203
Total nonoperating revenues	18,723	20,400	10,493
Total revenues	412,584	374,041	280,906
Operating expenses:			
Maintenance and operating	202,496	223,972	168,923
Depreciation	134,150	105,891	88,371
Total operating expenses	336,646	329,863	257,294
Nonoperating expenses:			
Interest expense	93,449	76,496	58,635
Loss on disposal of assets	1,297	549	541
Total nonoperating expenses	94,746	77,045	59,176
Total expenses	431,392	406,908	316,470
Excess (deficit) before contributions	(18,808)	(32,867)	(35,564)
Capital contributions	84,105	63,989	42,000
Change in net assets	65,297	31,122	6,436
Net assets, July 1	1,068,919	1,037,797	1,031,361
Net assets, June 30	$ 1,134,216	$ 1, 068,919	$ 1,037,797

Enplaned and deplaned passenger volume increased 6.4% in fiscal year 2006 and 7.1% in fiscal year 2005. Contributing causes for the increase in passengers include lessening fears of terrorist activity, a strong national economy, and an expanding population in the Airport Fund's service area. Increases in airport rates and charges accounted for approximately $25.6 million and $80.3 million of the increase in operating revenues in fiscal years 2006 and 2005 respectively. Detailed passenger statistics and comparative rates and charges can be found in the statistical section of this report.

Operating expenses increased by $6.8 million or 2.1% in fiscal year 2006. This includes a decrease of $41.4 million or 83.1% in pension expense, $34.8 million of which is the Fund's share of a collateralized pension obligation note issued by the City of Houston to the Houston Municipal Employees Pension System in fiscal year 2005. For additional information, please refer to notes 6 and 7 to the financial statements. Depreciation expense increased by $28.3 million, or 26.7%, during fiscal year 2006. This compares to a 7.5% increase in depreciable assets. Base salary expense increased $5.2 million or 11.5%, due in part to additional airport security personnel and additional personnel required for new facilities. Operating expenses in fiscal year 2005 increased by $72.5 million or 28.2%. Depreciation expense increased by $17.5 million or 19.8% and base salary expense increased $7.7 million or 20.5% in fiscal year 2005.

Capital contributions in fiscal year 2006 increased by $20.1 million or 31.4% over fiscal year 2005 due to an increase in discretionary grants awarded by the Federal Aviation Administration (FAA), and the Letter Of Intent from two federal fiscal years given in the same city fiscal year. In fiscal year 2005 capital contributions increased by $22.0 million or 52.4% due to an increase in discretionary grants awarded by the FAA.

Non-operating revenue decreased $0.7 million or 3.6% in fiscal year 2006. This was due to a $4.4 million downward adjustment in workers compensation reserve in fiscal year 2005 and unrealized changes in the fair value of the fund's investments. The total value of the Fund's investments increased by $34.7 million or 5.8%. Interest expense increased by $17.0 million or 22.2%. The increase is due to additional outstanding commercial paper, and interest rate increases on variable rate debt. In addition, the fund is responsible for a portion of the interest expense on a collateralized pension obligation note and on pension obligation bonds issued as general obligation debt during fiscal year 2005. In fiscal year 2005, non-operating revenue, principally interest revenue, increased by $13.1 million or 212.2%.

Capital Assets

The Airport System Fund's investment in capital assets amounts to $2.84 billion at June 30, 2006, an increase of $3.3 million or 0.1% from June 30, 2005. Capital assets at June 30, 2005 were $2.83 billion which was an increase of $225.1 million or 8.6% from June 30, 2004.

CAPITAL ASSETS
JUNE 30, 2006, JUNE 30, 2005, AND JUNE 30, 2004
(net of accumulated depreciation in thousands)

	June 30, 2006	June 30, 2005	June 30, 2004
Land	$ 198,614	$ 193,210	$ 170,087
Buildings and building improvements	1,321,043	1,277,613	826,913
Improvements other than buildings	941,683	874,957	883,334
Machinery and equipment	45,648	49,476	24,393
Construction in progress	329,210	437,613	703,073
	$ 2,836,198	$ 2,832,869	$ 2,607,800

Major capital projects ongoing during fiscal year 2006 included the rehabilitation of Terminal C at Intercontinental and the Central Concourse extension at Hobby. Additional information on the Fund's capital assets is provided in note 4 to the financial statements.

Debt

At the end of the current fiscal year, the Airport System Fund had total long-term debt of $2.26 billion, which represents outstanding subordinate lien revenue bonds, senior lien commercial paper, and an inferior lien contract, all secured solely by Airport Fund revenues. In addition, the Fund is responsible for a portion of a collateralized pension obligation note, pension obligation bonds, and a deferred electricity contract secured by a pledge against ad valorem taxes. At the end of fiscal years 2005 and 2004, the Fund had a total debt of $2.28 billion and $2.17 billion respectively.

OUTSTANDING DEBT
JUNE 30, 2006, JUNE 30, 2005, AND JUNE 30, 2004
(in thousands)

	June 30, 2006	June 30, 2005	June 30, 2004
Senior lien debt:			
Commercial paper	$ 59,000	$ 48,500	$ 20,000
Total senior lien debt	59,000	48,500	20,000
Subordinate lien debt:			
Revenue bonds payable	2,146,205	2,173,870	2,191,380
Unamortized discounts, premium, or deferred amounts on refunding	(38,359)	(39,798)	(40,986)
Total subordinate lien debt	2,107,846	2,134,072	2,150,394
Inferior lien contract:			
Contract payable	56,810	60,065	-
Total inferior lien contract	56,810	60,065	-
Other debt:			
Collateralized pension note	34,800	34,800	-
Pension obligation bonds	2,006	2,006	-
Deferred electricity contract	2,812	-	-
Total other debt	39,618	36,806	-
Total outstanding debt	$ 2,263,274	$ 2,279,443	$ 2,170,394

Total outstanding debt decreased $16.2 million or 0.7% during fiscal year 2006. During fiscal year 2005 the outstanding debt increased $109.0 million or 5.0%.

For a complete list of outstanding debt and required debt service, please refer to note 6 to the financial statements.

Standard & Poor's, Moody's, and Fitch's underlying ratings of the Airport System Fund's obligations are as follows:

Standard & Poor's	A
Moody's	A1
Fitch's	A+

STATEMENTS OF NET ASSETS (in thousands)
JUNE 30, 2006 AND 2005

	2006	2005
Assets		
Current assets		
Cash and cash equivalents	$ 55,187	$ 46,753
Equity in pooled cash and investments	572,391	547,450
Receivables (net of allowance for doubtful accounts of $2,292 in 2006 and $891 in 2005)		
Accounts receivable	29,598	30,456
Other receivables	-	1,651
Due from City of Houston	505	5,032
Inventory	3,334	3,441
Prepaid insurance	1,889	1,400
Due from other governments - grants receivable	9,731	10,967
Restricted assets		
Investments	8,023	6,696
Total current assets	680,658	653,846
Noncurrent assets		
Deferred charges	1,882	1,960
Capital Assets		
Land	198,614	193,210
Buildings, improvements and equipment	3,386,063	3,150,188
Construction in progress	329,210	437,613
Total capital assets	3,913,887	3,781,011
Less accumulated depreciation	(1,077,689)	(948,142)
Net capital assets	2,836,198	2,832,869
Total noncurrent assets	2,838,080	2,834,829
Total assets	$ 3,518,738	$ 3,488,675

(continued)

STATEMENTS OF NET ASSETS (in thousands)
JUNE 30, 2006 AND 2005

	2006	2005
Liabilities		
Current Liabilities		
Accounts payable	$ 4,143	$ 8,086
Accrued payroll liabilities	1,340	765
Due to City of Houston	-	2,863
Advances and deposits	1,844	1,735
Deferred revenue	8,127	1,225
Claims for workers' compensation	1,157	1,043
Compensated absences	3,286	2,893
Revenue bonds payable	28,385	27,665
Inferior lien contract payable	3,450	3,255
Accrued interest payable	49,070	49,667
Contracts and retainages payable	23,712	43,860
Other current liabilities	851	-
Total current liabilities	125,365	143,057
Long-term liabilities		
Revenue bonds payable, net	2,079,461	2,106,407
Inferior lien contract, net	53,360	56,810
Commercial paper payable	59,000	48,500
Collateralized note payable	34,800	34,800
Pension obligation bonds payable	2,006	2,006
Claims for workers compensation	2,292	1,625
Compensated absences	3,530	3,807
Arbitrage rebate payable	-	160
Net pension obligation payable	22,747	22,584
Other long-term liabilities	1,961	-
Total long-term liabilities	2,259,157	2,276,699
Total liabilities	2,384,522	2,419,756
Net assets		
Invested in capital assets, net of related debt	671,640	695,039
Restricted net assets		
Restricted for debt service	37,868	32,267
Restricted for maintenance and operations	38,322	34,160
Restricted for renewal and replacement	10,000	12,852
Restricted for capital improvements	376,386	292,416
Other restricted	-	2,185
Unrestricted	-	-
Total net assets	$ 1,134,216	$ 1,068,919

The accompanying notes are an integral part of the financial statements

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (in thousands) FOR YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
Operating Revenues		
Landing area fees	$ 101,758	$ 102,072
Rentals, building and ground area	179,951	151,417
Parking	62,377	55,444
Concessions	46,507	41,842
Other	3,268	2,866
Total operating revenues	393,861	353,641
Operating Expenses		
Maintenance and operating	202,496	223,972
Depreciation	134,150	105,891
Total operating expenses	336,646	329,863
Operating income	57,215	23,778
Nonoperating revenues (expenses)		
Interest revenue	18,507	14,968
Interest expense	(93,449)	(76,496)
Loss on disposal of assets	(1,297)	(549)
Arbitrage rebate recovery	160	1,137
Other revenue	56	4,295
Total nonoperating revenues (expenses)	(76,023)	(56,645)
Income/(loss) before capital contributions	(18,808)	(32,867)
Capital contributions	84,105	63,989
Change in net assets	65,297	31,122
Total net assets, July 1	1,068,919	1,037,797
Total net assets, June 30	$ 1,134,216	$ 1,068,919

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CASH FLOWS (in thousands)
FOR YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
Cash flows from operating activities		
Receipts from customers	$ 401,714	$ 337,583
Payments to employees	(76,049)	(72,384)
Payments to suppliers	(88,223)	(69,114)
Internal activity-payments to other funds	(35,296)	(39,629)
Claims paid	(1,157)	(5,447)
Other revenues	56	4,295
Net cash provided by operating activities	201,045	155,304
Cash flows from investing activities		
Sale of investments	402,535	559,931
Purchase of investments	(432,810)	(389,187)
Interest income on investments	22,515	14,531
Net cash (used for) provided by investing activities	(7,760)	185,275
Cash flows from noncapital financing activities		
Proceeds from issuance of pension obligation bonds	-	1,962
Interest expense pension obligation bonds	(98)	-
Interest expense collateralized note	(2,637)	-
Net cash (used for) provided by noncapital financing activities	(2,735)	1,962
Cash flows from capital and related financing activities		
Retirement of revenue bonds	(27,665)	(19,740)
Proceeds (use of cash) from issuance of debt	(655)	702
Interest expense on debt	(109,708)	(106,636)
Retirement of inferior lien contract	(1,628)	-
Proceeds from inferior lien contract	-	6,681
Proceeds from issuance of commercial paper	10,500	28,500
Advances and deposits	9	7
Contributed capital	85,342	54,242
Acquisition of capital assets	(138,311)	(279,548)
Net cash (used for) capital and related financing activities	(182,116)	(315,792)
Net increase in cash and cash equivalents	8,434	26,749
Cash and cash equivalents, beginning of year	46,753	20,004
Cash and cash equivalents, end of the year	$ 55,187	$ 46,753
Noncash transactions		
Unrealized loss (gain) on investments	(4,007)	437
Capitalized interest expense	19,913	32,634
Collateralized note	-	34,800
Inferior lien contract	-	51,756
Loss on disposal of assets	1,297	549
Noncash transactions	$ 17,203	$ 120,176
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 57,215	$ 23,778
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	134,150	105,891
Other revenues	56	4,295
Changes in assets and liabilities		
Accounts receivable	858	(15,007)
Due from the City of Houston	3,850	(3,208)
Inventory and prepaid insurance	(382)	(123)
Accounts payable	(475)	2,709
Accrued payroll liabilities	575	(1,891)
Due to the City of Houston	(2,863)	1,958
Advances and deposits	7,002	(1,065)
Net pension obligation payable	162	7,336
Claims for workers' compensation	781	(4,404)
Collateralized note payable	-	34,800
Compensated absences	116	235
Net cash provided by operating activities	$ 201,045	$ 155,304

The accompanying notes are an integral part of the financial statements

1. **Reporting Entity**

The Airport System Fund (Fund) of the City of Houston (City) is responsible for the operations, maintenance, and development of the City's Airport System. The Airport System consists of the George Bush Intercontinental Airport (Intercontinental), William P. Hobby Airport (Hobby) and Ellington Field.

The Mayor and City Council members serve as the governing body that oversees operation of the Fund. The Fund is operated by the Houston Airport System as a self-sufficient enterprise and is administered by the Houston Airport System Director, who reports to the City's Mayor.

The Fund is not financially accountable for any other operations, and accordingly, is accounted for as a single major enterprise fund with no component units. The Fund is included in the City's Comprehensive Annual Financial Report, which is a matter of public record.

2. **Summary of Significant Accounting Policies**

Basis of Accounting

The City accounts for the Fund as a proprietary fund. Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the City is that the cost of operations, including depreciation, be financed or recovered through user charges. The Fund is accounted for on a cost of services or "economic resources" measurement focus using the accrual basis of accounting, under which revenues are recognized in the accounting period in which they are earned and the related expenses are recorded in the accounting period incurred, if measurable. All assets and liabilities, current, non-current, and capital are included on the balance sheet.

The financial statements presented in this report conform to the reporting requirements of the Governmental Accounting Standards Board (GASB) which establishes generally accepted accounting principles for governmental entities. The Fund applies all Financial Accounting Standards Board (FASB) pronouncements issued prior to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Fund has elected not to follow FASB pronouncements issued subsequent to that date. The Fund defines operating revenues as receipts from customers and other receipts that do not result from transactions defined as capital and related financing, non-capital financing, or investing activities. All other revenue is recognized as non-operating. The Fund defines operating expenses as personnel and supply costs, utilities and other charges for service, the purchase of furniture and equipment with a value of less than $5,000, and other expenses that do not result from transactions defined as capital or related financing, non-capital financing, or investing activities. All other expense is recognized as non-operating.

Changes in Accounting Principles

In November 2003, the GASB issued Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries." This statement, among other things, established accounting and financial reporting standards for the impairment of capital assets. Under this standard, a capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This pronouncement, which the City implemented for the fiscal year ending June 30, 2006, had no impact upon the financial position, results of operations or cash flows of the City.

In June 2004, the GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefit Other Than Pension Plans." Statement No. 45 establishes

2. **Summary of Significant Accounting Policies, continued:**

standards for the measurement, recognition, and display of other postemployment benefits expenses and related liabilities and assets, and other related disclosure requirements. This statement will be implemented on or before the fiscal year ending June 30, 2008 to meet GASB requirements.

The City has taken steps to assess the current and future financial impact of its unfunded OPEB liabilities, and is reviewing the appropriate policies to address and manage any such liabilities. In preparation for the implementation of GASB 45, the City commissioned a preliminary actuarial study for use as a planning tool in order to assist the City in estimating the actuarial costs of other post-employment benefits and formulating a GASB 45 implementation plan. The preliminary actuarial study indicated that as of June 30, 2006 the City's total actuarial accrued liability (AAL) for benefits earned by the City's municipal employees and classified police officers and firefighters was approximately $3.2 billion, and the annually required contribution needed to pay the normal costs of the benefits and to effect a level amortization of the AAL over a 30 year period would have been approximately $326 million.

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

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

In December 2004, the GASB issued Statement No. 46. "Net Assets Restricted by Legislation – an amendment of GASB Statement No. 34." Statement No. 46 enhances the usefulness and comparability of net asset information reported by state and local governments by clarifying the meaning of the phrase 'legally enforceable' as it applies to restrictions imposed on net asset use. This statement was implemented beginning with fiscal year 2006. The Airport System Fund has $462.6 million of restricted net assets at June 30, 2006, most of which are due to covenants made to the holders of the Airport System Fund's revenue bonds within ordinances passed by the City Council. Out of these net assets, $37.9 million are restricted for debt service by enabling legislation.

In June 2005, the GASB issued Statement No. 47, "Accounting for Termination Benefits." Statement No. 47 requires employers to disclose a description of the termination benefit arrangement, the cost of the termination benefits (required in the period in which the employer becomes obligated if that information is not otherwise identifiable from information displayed on the face of the financial statements), and significant methods and assumptions used to determine termination benefit liabilities. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45. For all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005. This pronouncement had no impact upon the financial position, results of operations or cash flows of the City for the fiscal year ending June 30, 2006.

In September 2006, the GASB issued Statement No. 48, "Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues". Statement No. 48 improves financial reporting by establishing consistent measurement, recognition, and disclosure requirements that apply to both governmental and business-type activities. It establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor

2. **Summary of Significant Accounting Policies, continued:**

government either retains or relinquishes control over the receivables or future revenues. This Statement establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. The requirements for this Statement are effective for financial statements for periods beginning after December 15, 2006. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

Deposits and Investments

The Airport Fund does not separately account for most deposits and investments, but participates in a City-wide investment pool managed internally by City personnel. The City's investment policy requires all deposits to be fully collateralized with depository insurance; obligations of the United States of America or its agencies and instrumentalities (excluding those mortgage backed securities prohibited by the Public Funds Investment Act); or in any other manner and amount provided by law for the deposits of the City. At all times such securities are to have a fair value of not less than 102% of the amount of the deposits collateralized thereby, adjusted by the amount of applicable depository insurance.

Substantially all cash, except for imprest accounts, is deposited with financial institutions in interest bearing accounts or is invested. The majority of the City's investments are administered using a pooled concept, which combines the monies for various City funds, including the Fund, for investment purposes. These monies are displayed on the balance sheet as "cash and cash equivalents" and carried at fair value. Interest earnings of the pool are apportioned to the Fund based on its relative share of the investment pool. Restricted amounts on deposit in interest bearing accounts and other investments are displayed on the balance sheet as "investments" and carried at fair value. Investments authorized by the City's investment policy, which is guided by state laws and city ordinances, generally include: obligations of the United States of America or its agencies and instrumentalities, direct obligations of the State of Texas or its agencies and instrumentalities, other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of the State of Texas, or the United States, or their respective agencies and instrumentalities, obligations of states, agencies, counties, cities, and other political subdivisions, corporate commercial paper, fully collateralized repurchase agreements, and reverse repurchase agreements within specific terms. Investments are carried at fair value based on quoted market prices.

Statements of Cash Flows—Cash and Cash Equivalents

The Fund makes most of its deposits and withdrawals from the City's General Investment Pool, a pool that has the general characteristics of a demand deposit account, in that the Fund may deposit or effectively withdraw cash at any time without prior notice or penalty. The Fund has chosen to define cash and cash equivalents as the portion of its equity in the pool that is being used for operations. Equity in the pool that is being used for debt service or construction, or is restricted by bond covenants for a maintenance and operations reserve, is not considered cash and cash equivalents.

Inventories of Material and Supplies

Inventories of material and supplies are valued at average cost and charged to expense as used.

Capital Assets

The Fund defines capital assets as assets with an initial cost of more than $5,000. Acquired or

2. **Summary of Significant Accounting Policies, continued:**

constructed property is recorded at historical cost or estimated historical cost. Contributed property is recorded at the estimated fair value on the date received. Construction costs (excluding land and equipment) are added to construction work-in-progress until the assets are placed in service and are depreciated following completion. Depreciation on equipment begins in the year of acquisition. Interest costs on funds borrowed to finance the construction of capital assets are capitalized when the costs materially exceed interest earnings on related revenue bond proceeds. $19.9 million in interest costs was capitalized for the year ended June 30, 2006. $32.6 million was capitalized for the year ended June 30, 2005.

Depreciation on Airport System buildings and improvements is computed using the straight-line method on the component asset base over the estimated useful life, ranging from fifteen (15) to forty-five (45) years. Depreciation on equipment is computed using the straight-line method over the estimated useful life, ranging from four (4) to fifteen (15) years.

Compensated Absences

Full-time employees of the City are eligible for vacation leave of 10 working days per year. After 4 years of full-time employment with the City, they receive extra vacation time for each year of service, up to a maximum of 25 days at 18 years of employment. Employees hired before January 1, 2000 may accumulate up to 90 days of vacation leave, to be paid upon termination or retirement. Employees hired after December 31, 1999 may accumulate up to 45 days of vacation.

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

Vacation and other compensatory time benefits are accrued as liabilities as the benefits are earned, to the extent that the City's obligation is attributable to employees' services already rendered, and it is probable that the City will compensate the employees for the benefits through paid time off or some other means, such as cash payments.

Bond Discount and Issuance Costs

Bond discount and issuance costs are deferred and amortized over the term of the bonds using the effective interest method for fixed rate bonds and the straight line method for variable rate bonds. Gains or losses on bond refundings are amortized over the term of the lesser of the new bonds or the refunded bonds using the same respective methods.

3. **Deposits and Investments**

The Fund does not separately account for most deposits and investments, but participates in a City-wide investment pool managed internally by City personnel. The Fund's total equity in the

3. **Deposits and Investments, continued:**

City's General Investment Pool was $627,578,566 at June 30, 2006. The following deposit and investment disclosures generally relate to the City's General Investment Pool as a whole.

Deposits

The City's bank balance is the sum of three accounts in multiple investment pools which total $41,723,459. The three accounts that comprise this balance are described by the following:

Accounts	Ledger	Collected
Concentration 00103333903	$ 18,383,551	$ 14,005,907
Section 108 00103336856	406,507	406,507
JPM Money Market (does not include $17,251 in accrued interest)	22,933,401	22,933,401
subtotal	41,723,459	37,345,815
Market Value Collateral	$ 20,158,636	$ 20,158,636

The first account is a demand deposit account with JP Morgan Chase Bank, which as of June 30, 2006, had a ledger balance of $18,383,551 and a collected balance of $14,005,907. The difference between the ledger and collected balance of $4,377,644 represents checks deposited in this bank account for which the collection of available funds had not been obtained as of June 30, 2006. A Depository Pledge Agreement is in effect by which collateral is pledged by JP Morgan Chase to the City to cover collected balances. The collateral is in the form of high quality fixed income securities, held by a third party, and as of June 30, 2006 had a market value of $20,158,636. According to the terms of the pledge agreement the City is granted a security interest in the pledged securities. In the event of a default by JP Morgan Chase, the City may sell the pledged securities to satisfy any indebtedness owed to the City by JP Morgan Chase, provided at least 3 business days written notice and opportunity to cure the default is given.

The second account is a demand deposit account with JP Morgan Chase Bank for the City's Housing and Urban Development Section 108 account, which had both a collected and ledger balance as of June 30, 2006 of $406,507. This balance was collateralized by the same Depository Pledge Agreement described above.

At June 30, 2006, the carrying amount of the City's deposits in the third account, the General Investment Pool, was $22,933,401 which is invested in JPM Money Market Fund. This is a highly rated, SEC registered money market fund. As this is not a bank account, collateral is not required to be held to cover the balance. There is no custodial risk associated with this money market fund.

Cash and Cash Equivalents

The Airport Fund considers its cash and cash equivalents to be the portion of its equity in the General Investment Pool which is being used for operations. At June 30, 2006 and 2005, cash and cash equivalents for the Airport Fund were $55,187,465 and $46,753,165, respectively.

Investments and Risk Disclosures

The following describes the investment positions of the City's General Investment Pool as of June 30, 2006. As of that date, the General Investment Pool had $1,785,708,630 in high grade, fixed income investments. All investments are governed by state law and the City's Investment Policy,

3. **Deposits and Investments, continued:**

which dictates the following objectives, in order of priority:

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

These funds are managed internally by City personnel within a City-wide investment pool in order to gain operational efficiency. This pool consists of all working capital, construction and debt service funds which are not subject to yield restriction under IRS arbitrage regulations. The funds of the City's enterprise systems, as well as the general fund are commingled in this pool in order to gain operational efficiency. Approximately 95% of the City's total investable funds are contained in this portfolio.

Pooled Investments as of June 30, 2006	Credit Quality Ratings (1)(2)	Market Value	Weighted Average Maturity (yrs)
U.S. Treasury Notes	n/a	$ 287,623,336	0.640
Housing & Urban Development Dept ("HUD")	n/a	4,399,554	0.088
Government National Mortgage Association	AAA	3,256,867	8.601
Certificates of Deposits (less than $100,000 each)	FDIC Insured	481,486	0.666
Commercial Paper	A-1+	58,869,787	0.008
Agency Notes (4)	AAA	999,714,323	1.057
Agency Notes (3) (4)	not rated	103,637,114	1.175
Collateralized Mortgage Obligations (3) (4)	not rated	4,611,771	6.296
Mortgage Backed Securities (3) (4)	not rated	145,081,990	12.853
Municipal Bonds	AAA	128,783,129	1.619
Municipal Bonds	AA	16,572,156	1.207
Municipal Bonds	SP-1+/MIG1	53,276,503	0.960
Total Investments		$ 1,806,308,116	1.961

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

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

3. These securities are not individually rated by the rating agencies. The issuers of these securities, which include the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Corporation ("Fannie Mae"), are rated AAA by the rating agencies. Federal Agricultural Mortgage Corporation ("Farmer Mac"), which comprises 4.2% of this portfolio, is not rated by the credit rating agencies as to the individual securities or as an issuer. Farmer Mac is a government sponsored enterprise and is a permitted investment under state law and City investment policy.

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

3. **Deposits and Investments, continued:**

Risk Disclosures:

Interest Rate Risk: In order to ensure the ability of the City to meet obligations and to minimize potential fair value losses arising from rising interest rate environments, the City's investment policy limits the City's investment portfolio dollar-weighted average stated maturity to a maximum of 2.5 years. As of June 30, 2006, the City's investment portfolio dollar-weighted average stated maturity is 1.96 years. Modified duration for the same period is 1.176. Modified duration can be use as a multiplier to determine the percent change in price of a bond portfolio for every 100 basis point (1%) change in yield. For example, a portfolio with a modified duration of 1.176 would experience approximately a 1.176% change in market price for every 100 basis point change in yield.

Credit Risk: The US Treasury Notes and securities issued by HUD and the Government National Mortgage Association are direct obligations of the United States government. The Certificates of Deposit are for amounts less than $100,000 and guaranteed by the FDIC, an arm of the US government. The Commercial Paper, which is limited by law to maturities of 270 days or less, has the highest short-term rating of A-1+. The Agency Notes, Collateralized Mortgage Obligations and Mortgage Backed Securities are issued by government sponsored enterprises but are not direct obligations of the US government. The Municipal Securities that were issued as long-term securities are rated AAA or AA. The Municipal Securities that were considered short-term securities at time of issue, and thus were not given a long-term credit rating, have the highest short-term credit rating of MIG-1.

Custodial Credit Risk: The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2006, none of the City's investments in the General Investment Pool 960 were subject to custodial credit risk.

In addition, the City maintains several money market account balances for various purposes described below. The Airport Fund's portion of these is as follows:

Investments as of June 30, 2006	Credit Quality Ratings	Market Value	Weighted Average Maturity
JP Morgan U.S. Government Money Market Fund: Airport System Special Facilities Revenue Bonds Series 1997A Reserve Fund	AAA	$ 6,699,176	< 90 days
JP Morgan U.S. Government Money Market Fund: Balances held for auction rate debt service	AAA	1,182,726	< 90 days
First American Treasury Obligation Money Market Fund: Balances held for commercial paper debt service	AAA	141,301	< 90 days
Total Investments		$ 8,023,203	

3. **Deposits and Investments, continued:**

Risk Disclosures:

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

Credit Risk: These funds hold only U.S. dollar denominated securities that present minimal credit risk. They have the highest credit ratings Standard & Poor's and Moody's of AAA and Aaa respectively.

Custodial Credit Risk: The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the City of Houston will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2006, none of the City's investments in the above noted money market funds were subject to custodial credit risk.

4. **Capital Assets**

Summaries of changes in fixed assets for the years ended June 30, 2006 and June 30, 2005 follow (in thousands):

	Balance June 30, 2005	Additions	Retirements	Transfers	Balance June 30, 2006
Capital assets not being depreciated:					
Land	$ 193,210	$ 6,283	$ -	$ (879)	$ 198,614
Construction work in progress	437,613	130,525	-	(238,928)	329,210
Total capital assets not being depreciated	630,823	136,808	-	(239,807)	527,824
Other capital assets:					
Buildings and building improvements	1,595,120	-	(3,718)	117,349	1,708,751
Improvements other than buildings	1,455,275	4	(2,626)	120,020	1,572,673
Equipment	99,793	3,464	(1,056)	2,438	104,639
Total other capital assets	3,150,188	3,468	(7,400)	239,807	3,386,063
Less accumulated depreciation for:					
Buildings and building improvements	(317,507)	(73,357)	3,156		(387,708)
Improvements other than buildings	(580,318)	(51,103)	431		(630,990)
Equipment	(50,317)	(9,978)	1,304	-	(58,991)
Total accumulated depreciation	(948,142)	(134,438)	4,891	-	(1,077,689)
Other capital assets, net	2,202,046	(130,970)	(2,509)	239,807	2,308,374
Total capital assets, net	$ 2,832,869	$ 5,838	$ (2,509)	$ -	$ 2,836,198

4. **Capital Assets, continued:**

	Balance June 30, 2004	Additions	Retirements	Transfers	Balance June 30, 2005
Capital assets not being depreciated:					
Land	$ 170,087	$ 22,844	$ -	$ 279	$ 193,210
Construction work in progress	703,073	253,336	-	(518,796)	437,613
Total capital assets not being depreciated	873,160	276,180	-	(518,517)	630,823
Other capital assets:					
Buildings and building improvements	1,095,737	27,509	(48)	471,922	1,595,120
Improvements other than buildings	1,411,464	-	(736)	44,547	1,455,275
Equipment	71,949	27,877	(2,081)	2,048	99,793
Total other capital assets	2,579,150	55,386	(2,865)	518,517	3,150,188
Less accumulated depreciation for:					
Buildings and building improvements	(268,824)	(48,685)	2		(317,507)
Improvements other than buildings	(528,130)	(52,646)	458		(580,318)
Equipment	(47,556)	(4,796)	2,035	-	(50,317)
Total accumulated depreciation	(844,510)	(106,127)	2,495	-	(948,142)
Other capital assets, net	1,734,640	(50,741)	(370)	518,517	2,202,046
Total capital assets, net	$ 2,607,800	$ 225,439	$ (370)	$ -	$ 2,832,869

5. **Leases**

The Airport Fund is the lessee of office space for which it paid $104,000 and $91,000 in fiscal year 2006 and fiscal year 2005, respectively. This lease is operating and cancelable. The Airport Fund is the lessor of approximately 10 percent of its land and substantially all of its buildings and improvements. These lease agreements are non-cancelable operating leases with fixed minimum rentals and non-cancelable operating use and lease agreements with annually adjusted rates. Rental income is earned from leasing various parcels of land with asset costs of $19,861,357 to airlines, fixed base operators and various corporations for hangars, aircraft maintenance facilities, flight kitchens, and cargo buildings; to auto rental companies for their service facilities and storage lots; and to a variety of other entities for buildings and other permanent improvements. Airlines and airport concessionaires lease various sections of City owned airport buildings and improvements for ticket counters, passenger hold rooms, baggage carousels, restaurants, retail stores and other facilities. Leased buildings, improvements and equipment have asset costs of $3,386,063,321 and carrying costs of $2,308,374,551. Accumulated depreciation on all these assets is $1,077,688,770.

5. Leases, continued:

Minimum guaranteed income on such noncancelable operating leases is as follows (in thousands):

Year Ending June 30	Minimum Rental Income
2007	$ 35,799
2008	31,799
2009	29,921
2010	27,917
2011	26,391
2012-2016	113,985
2017-2021	101,303
2022-2026	94,372
2027-2031	37,732
2032-2036	11,216
2037-2041	10,257
2042-2046	3,561
Total	$ 524,253

Contingent income associated with these noncancelable operating leases was approximately $10,135,861 and $7,129,000 for the years ended June 30, 2006 and 2005, respectively. Contingent income is earned when a concessionaire's payment, based on a percentage of sales, is higher than the minimum amount guaranteed to the Airport System under the terms of the lease. In addition, income is earned from certain noncancelable operating use and lease agreements for landing fees and terminal building rentals. Such income is adjusted annually based on a compensatory formula to recover certain operating and capital costs of the related facilities. Compensatory income for the years ended June 30, 2006 and 2005 is as follows (in thousands):

	Compensatory Income	
	2006	2005
Landing fees	$ 98,004	$ 98,808
Terminal space	162,497	136,073
Total	$ 260,501	$ 234,881

6. Long-Term Liabilities

Changes in long-term liabilities for the years ended June 30, 2006 and 2005 are summarized as follows (in thousands):

6. Long-Term Liabilities, continued:

	Balance June 30, 2005	Additions	Retirements/ Transfers	Balance June 30, 2006	Amounts Due within One Year
Revenue bonds payable	$ 2,173,870	$ -	$ (27,665)	$ 2,146,205	$ 28,385
Plus unamortized premium	3,680	-	(322)	3,358	-
Less unamortized discount	(38,235)	-	1,314	(36,921)	-
Less deferred amount on refundings	(5,243)	-	447	(4,796)	-
Revenue bonds payable, net	2,134,072	-	(26,226)	2,107,846	28,385
Inferior lien contract	60,065	-	(3,255)	56,810	3,450
Less unamortized discount	-	-	-	-	-
Inferior lien contract, net	60,065	-	(3,255)	56,810	3,450
Commercial paper payable	48,500	10,500	-	59,000	-
Collateralized pension note	34,800	-	-	34,800	-
Pension obligation bonds	2,006	-	-	2,006	-
Compensated absences	6,700	6,499	(6,383)	6,816	3,286
Claims for workers compensation	2,668	1,938	(1,157)	3,449	1,157
Arbitrage rebate	160	-	(160)	-	-
Net pension obligation payable	22,584	163	-	22,747	-
Other long-term liabilities	-	2,812	-	2,812	851
Total long-term liabilities	$ 2,311,555	$ 21,912	$ (37,181)	$ 2,296,286	$ 37,129

	June 30, 2004	Additions	Retirements/ Transfers	Balance June 30, 2005	Amounts Due within One Year
Revenue bonds payable	$ 2,191,380	$ 92,900	$ (110,410)	$ 2,173,870	$ 27,665
Plus unamortized premium	3,996	-	(316)	3,680	-
Less unamortized discount	(41,066)	-	2,831	(38,235)	-
Less deferred amount on refundings	(3,916)	(1,719)	392	(5,243)	-
Revenue bonds payable, net	2,150,394	91,181	(107,503)	2,134,072	27,665
Inferior lien contract	-	60,065	-	60,065	3,255
Less unamortized discount	-	-	-	-	-
Inferior lien contract, net	-	60,065	-	60,065	3,255
Commercial paper payable	20,000	28,500	-	48,500	-
Collateralized pension note	-	34,800	-	34,800	-
Pension obligation bonds	-	2,006	-	2,006	-
Compensated absences	6,465	6,141	(5,906)	6,700	2,893
Claims for workers compensation	7,072	1,043	(5,447)	2,668	1,043
Arbitrage rebate	1,297	9	(1,146)	160	-
Net pension obligation payable	15,248	7,336	-	22,584	-
Total long-term liabilities	$ 2,200,476	$ 231,081	$ (120,002)	$ 2,311,555	$ 34,856

Purpose of Debt and New Debt

The Fund issues revenue bonds and commercial paper for the purpose of enlarging, maintaining and improving the Houston Airport System. The Fund has issued refunding bonds from time to time when there has been an operational or economic gain. These refundings have been structured as legal defeasances of the old debt as ruled by the Texas Attorney General, and such debt has been removed from the Fund's books.

On June 2, 2005 the Fund issued $92,900,000 in Airport System Subordinate Lien Revenue Refunding Bonds, Series 2005. Proceeds of the bonds were used to currently refund a portion of

6. **Long-Term Liabilities, continued:**

Airport System Subordinate Lien Revenue Refunding Bonds, Series 2000A, and to pay costs of issuance. The bonds mature on July 1, 2030. The bonds were issued as variable rate demand obligations with a weekly interest reset. The initial interest rate was 2.70%. Using a certified average rate of 4.85% for similar fixed rate debt issued at the same time, the cash savings on future debt service was $16,842,000 and the net present value saving of the transaction was $9,632,000. The acquisition price of the new debt exceeded the carrying value of the old debt by $1,718,681, which will be amortized over the life of the bonds.

Collateralized Pension Obligation Note

On November 10, 2004 the City issued a $300,000,000 collateralized note ("The Collateralized Note") to Houston Municipal Employees Pension System ("HMEPS") as part of the meet and confer agreement with HMEPS to fund part of the unfunded accrued actuarial liability of its pension plan. The Collateralized Note will bear interest at 8.5% per year unless the rate adjustment formula, based on U.S. Treasury securities maturing in 2033, calls for a higher interest rate. The promissory note from the Houston Hotel Corporation to the City, as well as the related Deed of Trust, has been pledged as collateral on the notes. Interest on the notes may be paid or deferred, at the City's option, up to a maximum of $150,000,000 plus 75% of the amount by which the appraised value of the hotel exceeds $300,000,000. If the interest is deferred, the City will issue uncollateralized deferred interest certificates that may be converted to assignable certificates at the request of HMEPS, up to $150 million, or collateralized deferred interest certificates up to the limit based on the appraised value of the hotel. The Collateralized Note constitutes a general obligation of the City with an ad valorem tax pledge, but the City may look to other revenue sources available to pay the debt, including the collateral and its proceeds as well as interest deferrals and contributions from proprietary funds. Because the liability is directly related to and expected to be paid from the Airport System Fund, the Combined Utility Fund, and the Convention and Entertainment Fund, part of the liability for the Collateralized Note has been allocated among these funds based on percentage of payroll for HMEPS contributions.

Taxable General Obligation Pension Bonds, Series 2005

On March 30, 2005 the City issued $57,165,000 in Taxable General Obligation Pension Bonds, Series 2005. The bonds mature in varying amounts between 2029 and 2035. The stated interest rate and the yield is 5.31%. Proceeds were used 1) to fund a portion of the unfunded actuarial accrued liability of the Houston Municipal Employees Pension System ("HMEPS"); 2) to refund the City's $22,900,000 Taxable Pension Obligation Note, Series 2004, which was issued to fund a portion of the unfunded actuarial accrued liability of the Houston Police Officers Pension System ("HPOPS"), and 3) to pay costs of issuance related to these bonds, including the cost of negotiating agreements with HMEPS and HPOPS. The refunding of the Note was undertaken to lower variable interest rate exposure rather than for savings.

The City pledged to assess and collect property taxes sufficient to pay debt service on these bonds.

Because the liability is directly related to and expected to be paid from the Airport System Fund, the Combined Utility Fund, and the Convention and Entertainment Fund, part of the liability for the Collateralized Note has been allocated among these funds based on percentage of payroll for HMEPS contributions.

6. Long-Term Liabilities, continued:

Debt Service Requirements to Maturity

Aggregate future Airport system debt service payments to maturity as of June 30, 2006 were as follows (in thousands):

Year Ending June 30	Revenue Bonds Principal	Revenue Bonds Interest	Commercial Paper Principal	Commercial Paper Interest
2007	$ 28,385	$ 107,729	$ -	$ 2,333
2008	29,825	106,267	59,000	1,201
2009	41,515	104,344	-	-
2010	43,020	102,143	-	-
2011	46,005	100,050	-	-
2012-2016	272,770	459,335	-	-
2017-2021	354,330	378,299	-	-
2022-2026	461,880	275,570	-	-
2027-2031	584,880	143,420	-	-
2032-2036	283,595	13,563	-	-
	$ 2,146,205	$ 1,790,720	$ 59,000	$ 3,534

Year Ending June 30	Inferior Lien Contract Principal	Inferior Lien Contract Interest	Pension Obligations Principal	Pension Obligations Interest
2007	$ 3,450	$ 3,030	$ -	$ 3,065
2008	3,660	2,816	-	3,065
2009	3,880	2,602	-	3,065
2010	4,085	2,388	-	3,065
2011	4,305	2,163	-	3,065
2012-2016	25,275	6,953	-	15,322
2017-2021	12,155	678	-	15,322
2022-2026	-	-	-	15,322
2027-2031	-	-	925	15,275
2032-2036	-	-	35,881	9,503
	-	-	-	-
	$ 56,810	$ 20,630	$ 36,806	$ 86,069

Year Ending June 30	Deferred Electricity Contract Principal	Deferred Electricity Contract Interest	Total Future Requirements Principal	Total Future Requirements Interest	Total Future Requirements
2007	$ 851	45	$ 32,686	$ 116,202	$ 148,888
2008	950	50	93,435	113,399	206,834
2009	1,011	53	46,406	110,064	156,470
2010	-	-	47,105	107,596	154,701
2011	-	-	50,310	105,278	155,588
2012-2016	-	-	298,045	481,610	779,655
2017-2021	-	-	366,485	394,299	760,784
2022-2026	-	-	461,880	290,892	752,772
2027-2031	-	-	585,805	158,695	744,500
2032-2036	-	-	319,476	23,066	342,542
	$ 2,812	$ 148	$ 2,301,633	$ 1,901,101	$ 4,202,734

6. **Long-Term Liabilities, continued:**

Certain bond ordinances have additional requirements for accumulation of principal and interest repayment amounts from surplus operating funds. Generally, the bonds may be redeemed prior to their maturities in accordance with the bond ordinances and at prices, which include premiums ranging downward from 5%. Significant additional restrictions and other data are set forth below. During 2006 and 2005, the City has substantially complied with the requirements of all financial revenue bond ordinances and related bond restrictions.

To the extent it legally may do so, the Fund covenants in the ordinances to charge rates for use of the Airport System in order that in each fiscal year the net revenues will be not less than 125% of the debt service requirements for Senior Lien Bonds for such fiscal year and 110% of the debt service requirements for Subordinate Lien Bonds for such fiscal year.

The Fund purchased a Municipal Debt Service Reserve Fund Surety Policy concurrently with the issuance of the Airport System Subordinate Lien Revenue Refunding Bonds Series 2005A. The reserve fund surety policy, along with previously issued reserve fund surety policies, unconditionally guarantees the payment of the current principal and interest on all outstanding airport system subordinate lien issues. The reserve policies terminate upon final maturity. Each of the draws made against the reserve policy shall bear interest at the prime rate plus two percent, not to exceed a maximum interest rate of 12%. The repayment provisions require one-twelfth of the policy costs for each draw to be repaid monthly, beginning the first month following the date of each draw.

Airport System Inferior Lien Contract

On July 1, 2004 the City and Continental Airlines, Inc. entered into a Sublease Agreement associated with the Special Facilities Lease for the Automated People Mover System and the City's Airport System Special Facilities Revenue Bonds (Automated People Mover System) Series 1997A ("1997A Special Facilities Bonds"). The Sublease became effective January 25, 2005. As part of the Sublease, the City agreed to make sublease payments that include amounts equal to the debt service on the 1997A Special Facilities Bonds. The payments are payable from Airport system net revenues on the same priority as inferior lien bonds. Accordingly, the principal amount of the 1997A Special Facilities Bonds, $60,065,000 was recorded as an Inferior Lien Contract.

Variable Rate Debt

The Fund has issued variable rate debt in Airport System Subordinate Lien Revenue Bonds Series 2000P-1 and Series 2000P-2. They were issued as auction reset securities with Series 2000P-1 to be auctioned every 7 days, and Series P-2 to be auctioned every 28 days. On July 20, 2005, Series P-2 changed to being auctioned every 7 days. Rates in effect at June 30, 2006, including dealer and auction fees, were 4.2575% and 4.2075%, respectively. Additional variable rate debt was issued as Series 2002C, Series 2002D-1, and Series 2002D-2 as auction rate securities to be auctioned every 35 days. These changed to being auctioned every 7 days as of August 10, 2005, August 3, 2005, and July 13, 2005, respectively. Rates in effect at June 30, 2006, including dealer and auction fees, were 4.245%, 4.305%, and 4.155%, respectively. Additional variable rate debt was issued during FY 2005 as Series 2005A, described under Purpose of Debt and New Debt above. Rates in effect at June 30, 2006, including remarketing fees, were 4.191%.

Revenue bonds payable for the years ended June 30, 2006 and 2005 (in thousands):

	Stated Interest Rate Range	Face Value Outstanding June 30, 2006	Face Value Outstanding June 30, 2005
Airport System Subordinate Lien Revenue Refunding Bonds, Series 1997, $33,255,000 original principal, matures in 2017	4.5%-5.125%	32,130	32,295
Airport System Subordinate Lien Revenue Refunding Bonds, Series 1998A, $70,405,000 original principal, matures in 2017	5.25%-6%	52,915	55,845
Airport System Subordinate Lien Revenue Bonds, Series 1998B $479,940,000 original principal, matures in 2028	3.90%-5.25%	443,215	455,975
Airport System Subordinate Lien Revenue Bonds Series 1998C $150,905,000 original principal. matures in 2028	3.90%-4.30%	148,595	149,395
Airport System Subordinate Lien Revenue Bonds Series 2000A, $327,225,000 original principal, matures in 2030	5%-6%	231,080	236,555
Airport System Subordinate Lien Revenue Bonds Series 2000B, $269,240,000 original principal, matures in 2030	5.45%-5.7%	269,240	269,240
Airport System Subordinate Lien Revenue Bonds Series 2000P-1, $50,000,000 original principal (Periodic Auction Reset Securities), matures in 2030	N/A	48,425	50,000
Airport System Subordinate Lien Revenue Bonds Series 2000P-2, $50,000,000 original principal (Periodic Auction Reset Securities), matures in 2030	N/A	48,200	49,125
Airport System Subordinate Lien Revenue Refunding Bonds Series 2001A, $65,475,000 original principal, matures in 2021	4%-5.5%	55,000	58,035
Airport System Subordinate Lien Revenue Bonds Series 2002A, $200,050,000 original principal, matures in 2032	5%-5.625%	200,050	200,050
Airport System Subordinate Lien Revenue Bonds Series 2002B, $274,455,000 original principal, matures in 2032	5%-5.5%	274,455	274,455
Airport System Subordinate Lien Revenue Bonds Series 2002C, $100,000,000 original principal (Auction Rate Securities), matures in 2032	N/A	100,000	100,000
Airport System Subordinate Lien Revenue Bonds Series 2002D-1, $75,000,000 original principal (Auction Rate Securities), matures in 2032	N/A	75,000	75,000
Airport System Subordinate Lien Revenue Bonds Series 2002D-2, $75,000.000 original principal (Auction Rate Securities), matures in 2032	N/A	75,000	75,000
Airport System Subordinate Lien Revenue Refunding Bonds Series 2005A, $92,900,000 original principal (Variable Rate Debt Obligations), matures in 2030	N/A	92,900	92,900
Total principal		2,146,205	2,173,870
Less:			
Total current maturities		(28,385)	(27,665)
Unamortized discount and issuance costs		(36,921)	(38,235)
Unamortized premium		3,358	3,680
Deferred amount on refunding		(4,796)	(5,243)
Total revenue bonds payable - long term		$ 2,079,461	$ 2,106,407

6. **Long-Term Liabilities, continued:**

Arbitrage Rebate

Arbitrage rebate rules, under Chapter 148 of the Federal Tax Code, require generally that a tax-exempt bond issuer pay to the federal government any profit made from investing bond proceeds at a yield above the bond yield, when investing in a taxable market. Payments based on cumulative profit are due, in general, every five years. Arbitrage rebate payable by the Airport Fund is as follows (in thousands):

Revenue Bonds	June 30, 2006	June 30, 2005	Arbitrage Due Date
Series 2002C,D-1,D-2	$ -	$ 151	8/15/2007
Series 2005A	-	9	6/2/2010
	$ -	$ 160	

Commercial Paper

Airport System Commercial Paper Notes (the "Notes") have been authorized for $150 million for Series A and B and $150 million for Series C to establish, improve, enlarge, extend and repair the Houston Airport System, acquire land, and pay interest and cost of issuance of the Notes. As of June 30, 2006 $25.5 million is outstanding in Series A and $33.5 million is outstanding in Series B.

Series A and B are collateralized by a direct pay letter of credit issued by two commercial banks, and a lien on the net revenues of the Fund. The letter of credit was $161,095,890 at June 30, 2006. It will terminate on January 4, 2008. The credit agreement covers the $150 million face value plus $11,095,890 in respect of 270 days accrued interest computed at 10%. The bank agrees to lend up to the amount of principal and interest outstanding during the time of the agreement, and that at the end of the agreement period, the outstanding loans will be consolidated into a single term loan to be repaid in six equal semiannual installments of principal plus interest commencing on a date which is six months after the termination of the Revolving Credit Period.

Series C is backed by a lien on the net revenues of the Fund, but is not collateralized.

7. **Defined Benefit Pension Plan**

The Fund participates in the pension plan of the City of Houston's municipal employees, for which separately published financial statements are available. Since the plan does not separately account for the Fund, the following disclosures, as well as those in Note 8, generally relate to the City as a whole. A complete copy of the plan can be obtained from the Houston Municipal Employees Pension System at 1111 Bagby, Suite 2450, Houston, Texas 77002-2555.

Plan Description

The Municipal Employees Pension System of the City is a single employer defined benefit pension plan that covers all eligible municipal employees, including all employees of the Fund. This pension plan was established under the authority of Texas statutes (Vernon's Texas Civil Statutes, Articles 6243g), which establish the various benefit provisions. The plan provides for service-connected disability and death benefits to survivors, with no age or service eligibility requirements. Employer and employee obligations to contribute, as well as employee contribution rates, are included in the statutes. Some requirements are delineated in the meet and confer

7. Defined Benefit Pension Plan, continued:

agreements of September 2004. Additionally, these laws provide that employer funding be based on periodic actuarial valuations, statutorily approved amounts or amounts agreed to in meet and confer agreements. The plan provides service, disability, death, and vesting benefits. The plan recognizes participant and employer contributions as revenues in the period in which they are due pursuant to formal commitments and recognizes benefits and refunds when they are due and payable in accordance with the terms of the pension statutes.

On November 10, 2004 the City issued a $300,000,000 collateralized note ("The Collateralized Note") to the Houston Municipal Employees Pension System ("HMEPS") as part of the meet and confer agreement with the HMEPS to fund part of the unfunded accrued actuarial liability of its pension plan. The notes will bear interest at 8.5% per year unless the rate of adjustment formula based on U.S. Treasury securities maturing in 2033, calls for a higher interest rate. The promissory note from the Houston Hotel Corporation to the City, as well as the related Deed of trust, has been pledged as collateral on the notes. Interest on the notes may be paid or deferred, at the City's option, up to a maximum of $150,000,000 plus 75% of the amount by which the appraisal value of the hotel exceeds $300,000,000. If the interest is deferred, the City will issue uncollateralized deferred interest certificates that may be converted to assignable certificates at the request of the HMEPS up to $150 million, or collateralized deferred interest certificates up to the limit based on the appraisal value of the hotel. The Collateralized Note constitutes a general obligation of the City with an ad valorem tax pledge, but the City may look to other revenue sources available to pay the debt, including the collateral and its proceeds as well as interest deferrals.

Actuarially Determined Contribution Requirements and Contributions Made

The City's funding policies provide for actuarially determined periodic contributions at rates such that, over time, they will remain level as a percent of payroll. The contribution rate for normal cost is determined using the entry age normal actuarial cost method. The pension plan uses the level percentage of payroll method to amortize the unfunded actuarially accrued liability (or surplus) over 30 years from July 1, 2004

The reported contributions to the pension funds for the year ended June 30, 2006, were different from the actuarially determined requirements based on the July 1, 2005 actuarial valuations. Contributions are as follows:

	Percentage of Payroll
City of Houston normal cost	15.6%
Amortization of unfunded actuarial accrued liability	8.5%
Required employer contribution rate	24.1%
Employer contribution made	16.5%
Employee contribution made	5.0%

	Contribution Amounts (in thousands)
Net contribution required	$ 122,633
Total City contribution	69,000
Total employee contribution	21,888
Total contribution	$ 90,888

7. **Defined Benefit Pension Plan, continued:**

Annual Pension Cost and Net Pension Obligation

The annual employer's pension cost associated with the Houston Municipal Employees' Pension System for the current year is as follows (in thousands):

Annual required contribution	$ 100,745
Interest on net pension obligation	16,135
Adjustment to annual required contribution *	(54,710)
Annual pension cost	62,170
Contribution made	69,000
Change in net pension obligation	6,830
Net pension obligation beginning	(231,144)
Net pension obligation end of year	$ (224,314)

* Includes an adjustment for the recalculation of the annual required contribution for prior years.

Schedule of Employer Contributions

Year Ended June 30	Annual Pension Cost (in millions)	Percentage Contributed	Net Pension Obligation (in millions)	Annual Required Contribution as a % of Base Pay
2003	$ 76.7	53.0%	$ 92.3	17.7%
2004	$133.5	43.6%	$167.8	31.8%
2005	$129.4	51.1%	$231.1	29.4%
2006	$ 62.2	111.0%	$224.3	24.1%

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as to the latest actuarial valuation is as follows:

Valuation date	July 1, 2005
Actuarial cost method	Normal cost
Amortization Method	Level percentage over open period of 30 yrs
Remaining amortization period	Rolling 30 year period
Asset valuation method	5 year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%, net of expenses
Payroll growth factor	3.0%
Projected salary increases	Graded rates based on years of service
General inflation rate	3.0%

8. **Other Employee Benefits**

Post-Retirement Health Insurance Benefits

Pursuant to a City Ordinance, the City provides certain health care benefits for retired employees. Substantially all of the City's employees become eligible for these benefits if they reach normal

8. **Other Employee Benefits, continued:**

retirement age while working for the City. Contributions are recognized in the year paid. The cost of retiree health care contributions incurred by the City amounted to approximately $50,809,267 and $49,891,440 for the years ended June 30, 2006 and 2005, respectively. Retiree health care is accounted for in the City's Health Benefits Fund, an Internal Service Fund. At June 30, 2006 and 2005, there were 8,436 and 8,125 retirees eligible to receive benefits, respectively.

Health Benefits Internal Service Fund

The City's Health Benefits plan is currently administered by HMO Blue Texas. Employees and retirees are able to choose between an HMO Plan with all benefits covered by third party purchased insurance or a substantially self insured with specific individual aggregate stop loss features Preferred Provider Organization Plan (PPO). Specific and aggregate stop loss insurance is provided for the PPO of $300,000 and approximately $11,000,000 based on enrollment, respectively. Premiums paid (employer and subscriber) for current employees to third party administrators totaled $152,268,079 and $136,454,304 for the years ended June 30, 2006 and 2005, respectively. Effectively, May 2004, the POS plan was replaced with self-insured Preferred Provider Organization (PPO).

The changes in the actuarial estimate of claims liability for the City related to the PPO/POS and PPO/OOA plans are as follows (in thousands):

PPO/POS and PPO/OOA
Schedule of Changes in Liability

	June 30, 2006	June 30, 2005
Beginning actuarial estimate of claims liability, July 1	$ 942	$ 1,011
Incurred claims for fiscal year	9,036	9,153
Payments on claims	(9,501)	(9,959)
Actuarial adjustment	494	737
Ending actuarial estimate of claims liability, June 30	$ 971	$ 942

The City provides one times salary of basic life insurance, with a minimum of $15,000, at no cost to the employee. The employee, at no cost to the City, may then obtain additional life insurance up to four times the employee's annual salary. The current cost for active employees for both basic and voluntary life insurance totaled $5,368,443 and $5,187,088 for the years ended June 30, 2006 and 2005, respectively.

Long-Term Disability Plan

The long-term disability plan, accounted for as an internal service fund of the City, is a part of the Income Protection Plan implemented effective September 1, 1985 (renamed the Compensable Sick Leave Plan (CSL) in October, 1996) and is provided at no cost to City employees who are members of CSL. Coverage is effective the later of September 1, 1985 or upon completion of two years of continuous service. When an employee cannot work because of injury or illness, the plan provides income equal to 50% of base pay plus longevity or 70% of base pay plus longevity when combined with income benefits available from other sources. Plan benefits may be payable after all CSL scheduled sick leave benefits, including frozen sick leave days, have been used, however, not before six months absence from work.

The plan is administered by Disability Management Alternatives, Inc., which is reimbursed from the fund for claims as they are paid along with a fee for administrative services. The change in the actuarial estimate of claims liability for the City is as follows (in thousands):

8. **Other Employee Benefits, continued:**

	Schedule of Changes in Liability (in thousands)	
	June 30, 2006	June 30, 2005
Beginning actuarial estimate of claims liability, July 1	$ 6,351	$ 5,799
Incurred claims for fiscal year	1,908	1,890
Payments on claims	(772)	(688)
Actuarial adjustment	(441)	(650)
Ending actuarial estimate of claims liability, June 30	$ 7,046	$ 6,351

Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code Section 457, in a separately administered trust. The Plan, available to all City employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. However, the Plan now offers loans to participant employees up to the lesser of $50,000 or 50% of the balance in their account less any outstanding loans. The minimum loan amount is $1,000. Pursuant to tax law changes, the Plan's assets are no longer subject to the claims of the City's general creditors and are not included in these financial statements.

9. **Transactions with City of Houston**

Interfund Services

The City charges the Fund for certain services performed by other City funds on behalf of the Airport System Fund. Such charges were as follows for the years ended June 30, 2006 and 2005 (in thousands):

	2006	2005
Police services	$ 18,083	$ 21,405
Fire services	11,925	11,153
Indirect support services	2,388	2,388
Water and sewer services	3,234	2,660
Other	652	773
Total	$ 36,282	$ 38,379

Indirect costs consist of costs incurred in connection with the general administration of City affairs, which cannot be directly associated with specific funds. Such costs include financial, materials management, legal, personnel and other administrative costs. These costs are allocated to the Fund each year based on an annual indirect cost study.

The Fund also pays for services provided by other City departments and funds, including the Combined Utility Fund for water and wastewater services and the internal service funds for risk financing activities.

9. Transactions with City of Houston, continued:

Due to and Due from the City of Houston

Amounts due to and due from other funds of the City at June 30, 2006 and 2005 are as follows (in thousands):

	2006		2005	
	Due to	Due from	Due to	Due from
General Fund	$ -	$ -	$ 2,609	$ 3,336
Internal Service Funds	-	-	-	-
Special Revenue Funds	-	505	253	1,696
Convention and Entertainment	-	-	1	-
Water and Sewer Fund	-	-	-	-
Total	$ -	$ 505	$ 2,863	$ 5,032

10. Major Customers

The Airport System Fund earns a significant portion of its operating revenues from two major customers as follows:

	Percentage of Operating Revenue	
	2006	2005
Continental Airlines	41.2%	38.2%
Continental Express	7.0%	5.1%
Continental	**48.2%**	**43.3%**
Southwest Airlines	**7.9%**	**8.7%**

11. Conduit Debt Obligations

From time to time, the City has authorized the issuance of bonds to enable various third parties to acquire and/or construct facilities deemed to be in the public interest. To provide for the airport facilities, the City has issued eight series of Special Facility Revenue Bonds. These bonds are limited special obligations of the City, payable solely from and secured by a pledge of revenue to be received from agreements between the City and various third parties. The bonds do not constitute a debt or pledge of the faith and credit of the City or the Fund and accordingly have not been reported in the accompanying financial statements, except for the City of Houston Special Facility Revenue Bonds (Automated People Mover System), Series 1997A, which are reported as an Inferior Lien Obligation because the City has contracted with Continental Airlines to operate certain facilities and pay related debt service.

At June 30, 2006, the aggregate value of Special Facility Revenue Bonds outstanding was $649,655,000, which includes $56,810,000 of the City of Houston Special Facility Revenue Bonds (Automated People Mover System), Series 1997A bonds. The Series 1997A bonds are supported by an inferior lien contract between the Fund and Continental Airlines which is included in the Fund's liabilities. At June 30, 2005, outstanding conduit bonds totaled $654,630,000.

12. Commitments and Contingencies

Litigation and Claims

The City is the defendant in various lawsuits arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. These matters affecting the Airport System are primarily class action and other lawsuits and claims alleging discriminatory pay practices. The status of such litigation ranges from an early discovery stage to various levels of appeal of judgments both for and against the City. The amount of damages is limited in certain cases under the Texas Tort Claims Act and is subject to appeal. The City intends to defend itself vigorously against the suits. Management has determined the amounts of loss, if any, would not be material in these financial statements.

Commitments

At June 30, 2006 and 2005, the Fund had contracted for, but not spent, $128,829,995 and $151,184,000, respectively, for capital projects.

Risk Management

The City carries fidelity coverage to comply with City ordinances, and purchases commercial property insurance with a per occurrence loss limit of $100 million. Such insurance provides a $2.5 million per occurrence deductible except for: 3% of the damaged insured value for windstorm or hail from a named storm, subject to $2.5 million minimum and a $20 million maximum; and a $5 million deductible for flood. Settlements for the Airport Fund have not exceeded insurance coverage for any of the last three fiscal years. In addition, the Airport Fund has purchased a separate policy to cover terrorism, for $100 million per occurrence and aggregate, with a $10 million deductible.

Through its Health Benefit Plan, the City has purchased commercial insurance up to certain limitations in the event of adverse loss experience. This insurance is discussed in the footnote 8, titled Other Employee Benefits.

The City is self-insured for claims pertaining to third party liability, unemployment and workers compensation. Self-insured claims are reported as liabilities in the accompanying financial statements when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. This determination is based on reported pending claims, estimates of claims, incurred but not yet reported, actuarial reports and historical analysis.

For unemployment claims, the City pays claims as they are settled. Unemployment claim activity is as follows:

	Unemployment Claim Activity	
	June 30, 2006	June 30, 2005
Unpaid claims, beginning of fiscal year	$ 115,511	$ 112,223
Incurred claims (including IBNRs)	432,208	1,114,092
Claim payments	(391,673)	(1,110,804)
Unpaid claims, end of fiscal year	$ 156,046	$ 115,511

For workers' compensation, the City has established a Workers' Compensation Self-Insurance Plan, accounted for within the various operating funds. The plan is administered by Cambridge

12. Commitments and Contingencies, continued:

Integrated Service Group, Inc. Funds are wire transferred to Cambridge as needed to pay claims.

At June 30, 2006, the City has an accumulated liability in the amount of $76.0 million to cover estimates for approved but unpaid claims and incurred but not reported claims (calculated on an actuarial basis). The amount of liability is based on the estimate of an independent actuary. The change in actuarial estimate of claims liability is as follows (in thousands):

	Schedule of Changes in Liability	
	June 30, 2006	June 30, 2005
Beginning actuarial estimate of claims liability, July 1	$ 62,307	$ 56,095
Incurred claims for fiscal year	10,796	16,202
Payments on claims	(14,218)	(18,337)
Actuarial adjustment	17,135	8,347
Ending actuarial estimate of claims liability, June 30	$ 76,020	$ 62,307

Amounts received or receivable from grantor agencies are subject to audit and adjustment by grantor agencies. Any disallowed claims, including amounts already collected, could be a liability of the Fund.

Electricity Futures Contracts

Objective of the futures contracts. The City's electric supply agreement provides that the City will purchase electricity at prices based on market prices of natural gas at time of delivery. Therefore the City is exposed to significant price fluctuations in its electricity purchases. The agreement also allows the City to lock in fixed natural gas prices for future periods. To hedge the risk of increases and to be able to accurately budget future purchase, the City has entered into contracts to lock in fixed rates for the natural gas price component of future electricity purchases.

Terms: At June 30, 2006, the City had seven outstanding agreements to cover natural gas purchases for July 2006 through March 2007. As of June 30, 2006, the aggregate notional amount of the seven agreements was 673.50 contracts or 6,735,000 million British thermal units (MMBtu's) of natural gas. Locked-in prices ranged from $6.12 to $10.41 per MMBtu.

Fair value: As of June 30, 2006, because natural gas futures prices had changed from the time of the agreements, the contracts had a total net fair value of negative $5,309,000. (Contracts for four future months had a total positive value of $405,000, and contracts for five other months had a total negative value of $5,714,000.)

Credit risk: As of June 30, 2006 the City is exposed to credit risk on the contracts for four months with fair positive value of $405,000. The City's electrical provider is the Texas General Land Office ("GLO"), an agency of the State of Texas, which is rated AA1 by Moody's, AA by Standard and Poor's, and AA+ by Fitch.

Termination risk: GLO can terminate the electrical supply agreement (and related price agreements) only if the City defaults on its obligations. The City can unwind the price agreements at its discretion, paying or receiving market value credit at the time of the unwind.

REQUIRED PENSION SYSTEM SUPPLEMENTARY INFORMATION

MUNICIPAL PENSION SYSTEM SUPPLEMENTARY INFORMATION (Unaudited)

Schedule of Funding Progress (Millions)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (Surplus UAAL) (b-a)	Funded Ratio (a/b)	Projected Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
July 1, 1998	$1,095.6	$1,240.1	$144.5	88%	$397.7	36%
July 1, 1999	$1,222.2	$1,339.9	$117.7	91%	$407.7	29%
July 1, 2000	$1,376.0	$1,509.4	$133.4	91%	$432.6	31%
July 1, 2001	$1,490.2	$1,955.8	$465.6	76%	$418.0	111%
July 1, 2002	$1,519.7	$2,515.2	$995.5	60%	$399.8	249%
July 1, 2003	$1,510.3	$3,278.3	$1,768.0	46%	$390.3	453%
July 1, 2004	$1,501.2	$2,633.8	$1,132.5	57%	$366.1	309%
July 1, 2005	$1,777.7	$2,725.3	$947.6	65%	$404.6	234%

COMPREHENSIVE ANNUAL FINANCIAL REPORT

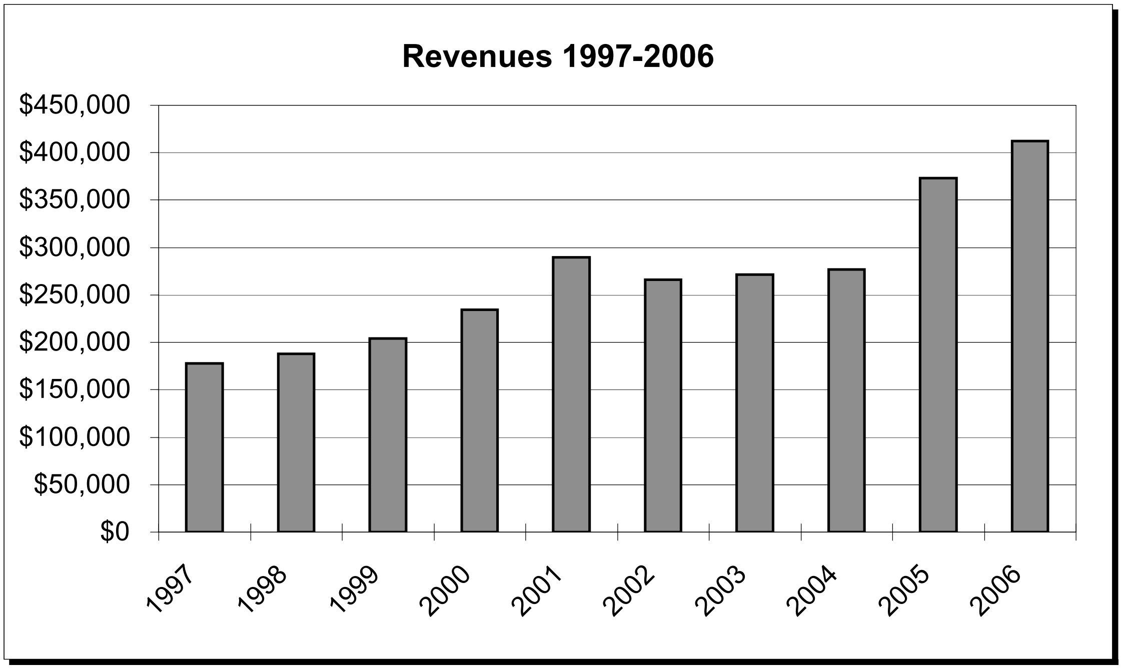
STATISTICAL SECTION

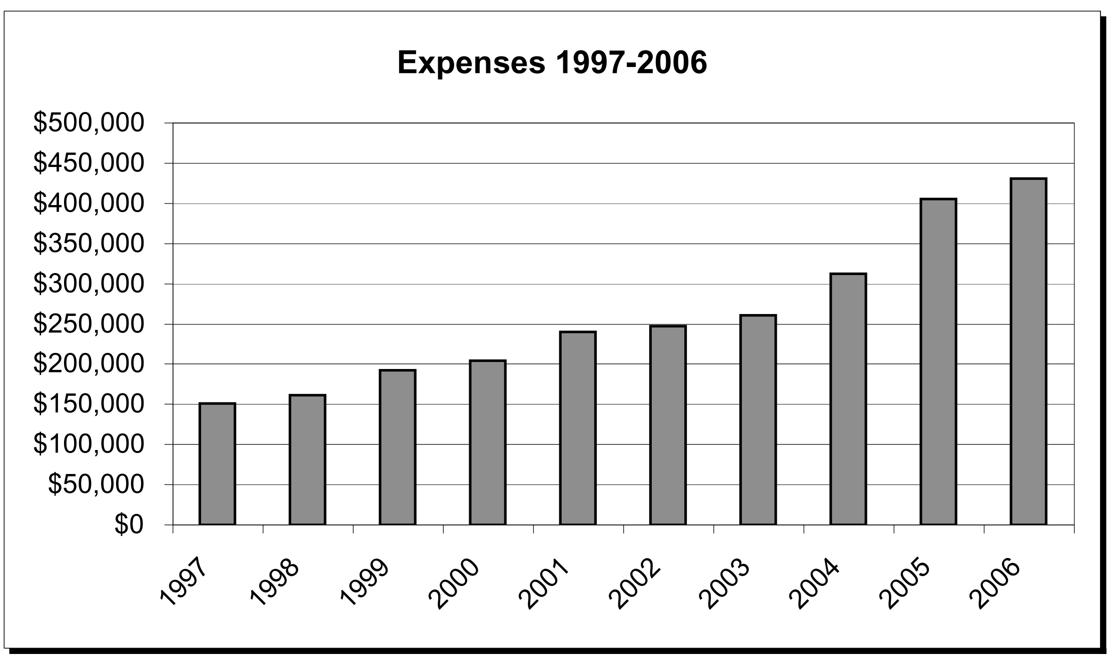
(Unaudited)

CITY OF HOUSTON

TEXAS

TOTAL ANNUAL REVENUES AND TOTAL ANNUAL EXPENSES (in thousands)
STATISTICAL SECTION





TOTAL ANNUAL REVENUES AND TOTAL ANNUAL EXPENSES (in thousands)
STATISTICAL SECTION

TOTAL ANNUAL REVENUES LAST TEN FISCAL YEARS	**1997**	**1998**	**1999**	**2000**
OPERATING REVENUES				
Landing area fees	$ 43,371	$ 43,739	$ 37,506	$ 40,930
Building and ground area fees	54,362	54,479	59,921	72,988
Concession and parking revenues	69,272	75,827	84,944	95,217
TOTAL OPERATING REVENUES	167,005	174,045	182,371	209,135
NONOPERATING REVENUES				
Interest revenue	10,894	13,213	21,762	25,027
Other nonoperating revenues	56	664	207	188
TOTAL NONOPERATING REVENUES	10,950	13,877	21,969	25,215
TOTAL REVENUES	$ 177,955	$ 187,922	$ 204,340	$ 234,350

TOTAL ANNUAL EXPENSES LAST TEN FISCAL YEARS	**1997**	**1998**	**1999**	**2000**
OPERATING EXPENSES				
Maintenance and operating	$ 93,471	$ 100,040	$ 117,206	$ 113,442
Depreciation	39,002	43,166	42,537	46,390
TOTAL OPERATING EXPENSES	132,473	143,206	159,743	159,832
NONOPERATING EXPENSES				
Interest expense and others	18,859	18,376	32,471	44,354
TOTAL NONOPERATING EXPENSES	18,859	18,376	32,471	44,354
TOTAL EXPENSES	$ 151,332	$ 161,582	$ 192,214	$ 204,186

2001	2002	2003	2004	2005	2006
$ 48,298	$ 50,826	$ 51,162	$ 57,011	$ 102,072	$101,758
74,168	84,752	91,801	115,777	151,417	179,951
99,708	91,877	97,804	97,625	100,152	112,152
222,174	227,455	240,767	270,413	353,641	393,861
66,846	37,629	30,278	5,967	14,968	18,507
828	942	681	203	4,295	56
67,674	38,571	30,959	6,170	19,263	18,563
$ 289,848	$ 266,026	$ 271,726	$ 276,583	$ 372,904	$ 412,424

2001	2002	2003	2004	2005	2006
$ 122,594	$ 142,950	$ 154,541	$ 168,923	$ 223,972	$ 202,496
52,410	60,088	59,987	88,371	105,891	134,150
175,004	203,038	214,528	257,294	329,863	336,646
64,825	44,165	46,538	54,853	75,908	94,586
64,825	44,165	46,538	54,853	75,908	94,586
$ 239,829	$ 247,203	$ 261,066	$ 312,147	$ 405,771	$ 431,232

CITY OF HOUSTON, TEXAS

TOTAL NET ASSETS AND CHANGES IN NET ASSETS (in thousands)
STATISTICAL SECTION

CHANGES IN NET ASSETS	1997	1998	1999	2000
OPERATING REVENUES				
Landing area fees	$ 43,371	$ 43,739	$ 37,506	$ 40,930
Building and ground area fees	54,362	54,479	59,921	72,988
Concession and parking revenues	69,272	75,827	84,944	95,217
TOTAL OPERATING REVENUES	167,005	174,045	182,371	209,135
OPERATING EXPENSES				
Maintenance and operating	93,471	100,040	117,206	113,442
Depreciation	39,002	43,166	42,537	46,390
TOTAL OPERATING EXPENSES	132,473	143,206	159,743	159,832
NONOPERATING REVENUES (EXPENSES)				
Interest Income	10,894	13,213	21,762	25,027
Other nonoperating revenues	56	664	207	188
Interest expense and others	(18,859)	(18,376)	(32,471)	(44,354)
TOTAL NONOPERATING REV (EXP)	(7,909)	(4,499)	(10,502)	(19,139)
CONTRIBUTIONS	6,382	15,734	15,679	18,693
TOTAL CHANGES IN NET ASSETS	$ 33,005	$ 42,074	$ 27,805	$ 48,857

NET ASSETS AT YEAR-END	1997	1998	1999	2000
Invested in capital assets, net of related debt				
Restricted net assets				
Restricted for debt service				
Restricted for maintenance and operations				
Restricted for renewal and replacement				
Restricted for capital improvement				
Other restricted				
Unrestricted				
TOTAL NET ASSETS	$ 716,437	$ 758,511	$ 786,316	$ 835,173

2001	2002	2003	2004	2005	2006
$ 48,298	$ 50,826	$ 51,162	$ 57,011	$ 102,072	$ 101,758
74,168	84,752	91,801	115,777	151,417	179,951
99,708	91,877	97,804	97,625	100,152	112,152
222,174	227,455	240,767	270,413	353,641	393,861
122,594	142,950	154,541	168,923	223,972	202,496
52,410	60,088	59,987	88,371	105,891	134,150
175,004	203,038	214,528	257,294	329,863	336,646
66,846	37,629	30,278	5,967	14,968	18,507
828	942	681	203	4,295	56
(64,825)	(44,165)	(46,538)	(54,853)	(75,908)	(94,586)
2,849	(5,594)	(15,579)	(48,683)	(56,645)	(76,023)
19,873	51,286	45,527	42,000	63,989	84,105
$ 69,892	$ 70,109	$ 56,187	$ 6,436	$ 31,122	$ 65,297

2001	2002	2003	2004	2005	2006
	$ 690,014	$ 648,027	$ 668,742	$ 695,039	$ 671,640
	32,281	84,529	40,229	32,267	37,868
	28,035	28,123	31,337	34,160	38,322
	13,819	13,572	12,947	12,852	10,000
	202,808	251,061	282,494	292,416	376,386
	1,952	2,092	2,048	2,185	-
	6,265	3,957	-	-	-
$ 905,065	$ 975,174	$ 1,031,361	$ 1,037,797	$ 1,068,919	$ 1,134,216

REVENUE BOND COVERAGE (in thousands)
STATISTICAL SECTION

	1997	1998	1999
Gross revenues	$173,141	$183,953	$192,209
Maintenance and operating expenses	(95,028)	(100,040)	(117,206)
Net revenue	$78,113	$83,913	$75,003
Required revenue per bond covenant	$36,604	$36,530	$37,477
Less grant revenue available for debt service	-	-	-
Net required revenue per bond covenant	$36,604	$36,530	$37,477
Ratio of required revenue	2.13	2.30	2.00
Total debt service	$32,220	$32,955	$33,942
Less grant revenue available for debt service	-	-	-
Debt service requirement (per bond ordinance)	$32,220	$32,955	$33,942
Coverage of debt service	2.42	2.55	2.21

Gross revenues include all operating revenue of the Airport Fund, and all non-operating revenue except for interest and other revenue earned by the construction funds. Maintenance and operating expenses include all operating expenses of the system except for depreciation. Net revenues in each fiscal year are required to be at least equal to the larger of either: (1) the debt service and reserve transfer requirements of each fiscal year or; (2) 125%, 110%, and 100% of the debt service requirements for such fiscal year of the Senior Lien Bonds (or Commercial Paper assumed to be refinanced as Senior Lien Revenue Bonds), Subordinate Lien Revenue Bonds, and Inferior Lien debt, respectively.

Debt service requirement is equal to interest expense (excluding amortization of bond discount, and amounts provided for payment of interest from bond proceeds and other sources and deposited into restricted fund for that purpose) for each respective fiscal year ended June 30, plus principal payment payable on the next July 1. Starting in Fiscal Year 1998, debt service requirements include interest on commercial paper whereas the other fiscal years do not. Starting in Fiscal Year 2001, certain grant revenue is available to cover net required revenue and required debt service.

2000	2001	2002	2003	2004	2005	2006
$218,911	$ 235,250	$ 244,791	$ 251,921	$ 278,933	$ 368,314	$ 411,545
(113,442)	(122,594)	(142,950)	(154,541)	(161,645)	(191,093)	(205,565)
$105,469	$112,656	$101,841	$97,380	$117,288	$177,221	$205,980
$42,401	$ 55,203	$ 56,782	$ 70,396	$ 83,382	$ 123,266	$ 154,127
-	(2,798)	(37,153)	(30,282)	(32,823)	(25,506)	(46,621)
$42,401	$52,405	$19,629	$40,114	$50,559	$97,760	$107,506
2.49	2.15	5.19	2.43	2.32	1.81	1.92
$38,455	$ 50,027	$ 51,611	$ 63,988	$ 75,797	$ 112,248	$ 140,513
-	(2,798)	(37,153)	(30,282)	(32,823)	(25,506)	(46,621)
$38,455	$47,229	$14,458	$33,706	$42,974	$86,742	$93,892
2.74	2.39	7.04	2.89	2.73	2.04	2.19

PLEDGED REVENUES (in thousands)
STATISTICAL SECTION

	2002	2003	2004	2005	2006
Net Revenues					
Operating revenues	$ 227,455	$ 240,767	$ 270,413	$ 353,641	$ 393,861
Interest income	11,816	10,650	8,406	10,499	17,742
Other nonoperating revenues	5,520	504	114	4,175	(58)
Gross revenues	244,791	251,921	278,933	368,315	411,545
Less: Maintenance & Operating expenses	(142,950)	(154,541)	(161,645)	(191,093)	(205,565)
Net pledged revenues	$ 101,841	$ 97,380	$ 117,288	$ 177,222	$ 205,980
Debt Service					
Principal	$ 4,380	$ 17,985	$ 18,865	$ 28,182	$ 31,737
Interest	47,231	46,003	56,932	84,066	108,776
Less: Grants available for debt service	(37,153)	(30,282)	(32,823)	(25,506)	(46,621)
Total debt service	$ 14,458	$ 33,706	$ 42,974	$ 86,742	$ 93,892
Debt Service Coverage	7.04	2.89	2.73	2.04	2.19

OUTSTANDING DEBT (in thousands)
STATISTICAL SECTION

	2002	2003	2004	2005	2006
Outstanding debt by type					
Current liabilities					
Revenue bonds payable	$ 4,380	$ 17,985	$ 18,865	$ 27,665	$ 28,385
Inferior lien contract payable	-	-	-	3,255	3,450
Commercial paper payable	-	-	20,000	-	-
Deferred electricity payable	-	-	0	-	851
Total current liabilities	$ 4,380	$ 17,985	$ 38,865	$ 30,920	$ 32,686
Long-term liabilities					
Revenue bonds payable	$ 1,484,860	$ 2,191,380	$ 2,172,515	$ 2,146,205	$ 2,117,820
Inferior lien contract payable	-	-	-	56,810	53,360
Commercial paper payable	20,000	-	-	48,500	59,000
Deferred electricity payable	-	-	-	-	1,961
Total long-term liabilities	$ 1,504,860	$ 2,191,380	$ 2,172,515	$ 2,251,515	$ 2,232,141
Total outstanding debt	$ 1,509,240	$ 2,209,365	$ 2,211,380	$ 2,282,435	$ 2,264,827
Total enplaned passengers	20,941,865	20,604,509	21,779,196	23,357,279	24,912,085
Outstanding debt per enplaned passenger	$ 72.07	$ 107.23	$ 101.54	$ 97.72	$ 90.91

PASSENGER STATISTICS
LAST TEN YEARS

	Domestic Passengers					
	Intercontinental		Hobby		Ellington Field	
Fiscal Year	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change
1997	23,839	5.8%	8,330	1.5%	101	13.5%
1998	25,543	7.1%	8,597	3.2%	113	11.9%
1999	27,271	6.8%	8,795	2.3%	100	-11.5%
2000	28,892	5.9%	9,053	2.9%	89	-11.0%
2001	30,105	4.2%	9,038	-0.2%	64	-28.1%
2002	28,168	-6.4%	8,192	-9.4%	68	6.3%
2003	27,931	-0.8%	7,796	-4.8%	81	19.1%
2004	29,473	5.5%	8,089	3.8%	80	-1.2%
2005	31,609	7.2%	8,247	2.0%	14	-82.5%
2006*	34,105	7.9%	8,423	2.1%	0	-100.0%

* Preliminary figures for FY 2006

Domestic Passengers		International Passengers			
Total		Intercontinental		Total Passengers	
Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change	Enplanements & Deplanements (in thousands)	Percentage Change
32,270	4.6%	3,614	14.8%	35,884	5.6%
34,253	6.1%	4,161	15.1%	38,414	7.1%
36,166	5.6%	4,801	15.4%	40,967	6.6%
38,034	5.2%	5,340	11.2%	43,374	5.9%
39,207	3.1%	5,811	8.8%	45,018	3.8%
36,428	-7.1%	5,556	-4.4%	41,984	-6.7%
35,808	-1.7%	5,526	-0.5%	41,334	-1.5%
37,642	5.1%	5,952	7.7%	43,594	5.5%
39,870	5.9%	6,818	14.5%	46,688	7.1%
42,528	6.7%	7,126	4.5%	49,654	6.4%

PASSENGER STATISTICS (Cont.)
FOR YEARS ENDED JUNE 30, 2006 and 2005

Domestic

	Intercontinental				Hobby			
	Fiscal Year 2006*		Fiscal Year 2005		Fiscal Year 2006*		Fiscal Year 2005	
Airlines	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
Air Tran	0	0.0%	0	0.0%	339,652	4.0%	341,950	4.1%
America West	367,327	0.9%	454,592	1.2%	0	0.0%	0	0.0%
American Airlines, Inc.	1,075,834	2.6%	1,052,115	2.7%	55,324	0.7%	71,887	0.9%
American Connection	0	0.0%	0	0.0%	15,558	0.2%	0	0.0%
American Eagle - AA	0	0.0%	0	0.0%	263,438	3.1%	231,280	2.8%
ATA Airlines	0	0.0%	0	0.0%	51,212	0.6%	0	0.0%
Atlantic Southeast - DL	133,327	0.3%	117,864	0.3%	100,629	1.2%	111,435	1.4%
Charter Airlines	2,555	0.0%	20,623	0.1%	4,357	0.1%	2,627	0.0%
Chautauqua Airlines - DL	0	0.0%	43,897	0.1%	10,761	0.1%	0	0.0%
Chautauqua Airlines - UA	16,330	0.0%	89,074	0.2%	0	0.0%	0	0.0%
Colgan - Air Inc, - CO	511,621	1.2%	63,671	0.2%	0	0.0%	0	0.0%
Comair - DL	103,296	0.3%	64,440	0.2%	0	0.0%	18,295	0.2%
Continental	20,940,495	50.8%	19,898,394	51.8%	0	0.0%	28,045	0.3%
ExpressJet Airlines, Inc. - CO	8,478,037	20.6%	6,720,126	17.5%	0	0.0%	14,590	0.2%
Delta	528,212	1.3%	624,435	1.6%	139,753	1.7%	303,853	3.7%
Frontier	171,639	0.4%	189,928	0.5%	0	0.0%	0	0.0%
Mesa Airlines, Inc. - America We	40,743	0.1%	1,882	0.0%	0	0.0%	0	0.0%
Mesa Airlines, Inc. - US	148,648	0.4%	399	0.0%	0	0.0%	0	0.0%
Midwest Airlines, Inc.	0	0.0%	0	0.0%	19,971	0.2%	0	0.0%
MN Airlines, Inc.	0	0.0%	0	0.0%	7,073	0.1%	0	0.0%
Northwest	600,100	1.5%	677,689	1.8%	0	0.0%	0	0.0%
PSA Airlines - US	30,909	0.1%	59,481	0.2%	0	0.0%	0	0.0%
Republic Airlines - US	57,027	0.1%	0	0.0%	0	0.0%	0	0.0%
Shuttle America Corporation - U	135,294	0.3%	0	0.0%	0	0.0%	0	0.0%
SkyWest Airlines - CO	48	0.0%	292,458	0.8%	0	0.0%	0	0.0%
SkyWest Airlines - DL	2,809	0.0%	0	0.0%	0	0.0%	0	0.0%
SkyWest Airlines - UA	72,382	0.2%	14,306	0.0%	0	0.0%	0	0.0%
Southwest Airlines Company	0	0.0%	167,757	0.4%	7,415,573	88.0%	7,123,101	86.4%
United Air Lines, Inc.	465,768	1.1%	625,191	1.6%	0	0.0%	0	0.0%
US Airways	222,137	0.5%	430,220	1.1%	0	0.0%	0	0.0%
Total Domestic	34,104,538	82.7%	31,608,542	82.3%	8,423,301	100.0%	8,247,063	100.0%

International

	Fiscal Year 2006*		Fiscal Year 2005		Fiscal Year 2006*		Fiscal Year 2005	
	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
AeroMexico	140,916	0.3%	127,672	0.3%				
Aerolitoral	80	0.0%	183	0.0%				
Air Canada	21,738	0.1%	72,122	0.2%				
Air Canada Jazz	156,704	0.4%	66,058	0.2%				
Air France	194,632	0.5%	156,596	0.4%				
Air Jamaica	0	0.0%	16,441	0.0%				
Aviacsa	70,363	0.2%	107,307	0.3%				
British Airways	217,221	0.5%	193,060	0.5%				
Cayman Airways, LTD.	13,291	0.0%	10,775	0.0%	Domestic only			
Charter Airlines	54,113	0.1%	103,903	0.3%				
China Airlines	54,614	0.1%	54,456	0.1%				
Continental	4,454,118	10.8%	4,404,803	11.5%				
ExpressJet Airlines, Inc.	1,292,759	3.1%	1,039,670	2.7%				
KLM	215,816	0.5%	220,939	0.6%				
Lufthansa	147,894	0.4%	145,599	0.4%				
Pakistan Int'l Airlines	30,454	0.1%	28,692	0.1%				
TACA	61,265	0.1%	69,510	0.2%				
Total International	7,125,978	17.3%	6,817,786	17.7%				
Total Airlines	41,230,516	100.0%	38,426,328	100.0%	8,423,301	100.0%	8,247,063	100.0%

* Preliminary figures for FY 2006

Ellington				Houston Airport System			
Fiscal Year 2006*		Fiscal Year 2005		Fiscal Year 2006*		Fiscal Year 2005	
Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
0	0.0%	0	0.0%	339,652	0.7%	341,950	0.7%
0	0.0%	0	0.0%	367,327	0.7%	454,592	1.0%
0	0.0%	0	0.0%	1,131,158	2.3%	1,124,002	2.4%
0	0.0%	0	0.0%	15,558	0.0%	0	0.0%
0	0.0%	0	0.0%	263,438	0.5%	231,280	0.5%
0	0.0%	0	0.0%	51,212	0.1%	0	0.0%
0	0.0%	0	0.0%	233,956	0.5%	229,299	0.5%
0	0.0%	0	0.0%	6,912	0.0%	23,250	0.0%
0	0.0%	0	0.0%	10,761	0.0%	43,897	0.1%
0	0.0%	0	0.0%	16,330	0.0%	89,074	0.2%
0	0.0%	0	0.0%	511,621	1.0%	63,671	0.1%
0	0.0%	0	0.0%	103,296	0.2%	82,735	0.2%
0	0.0%	0	0.0%	20,940,495	42.2%	19,926,439	42.7%
0	0.0%	14,379	100.0%	8,478,037	17.1%	6,749,095	14.5%
0	0.0%	0	0.0%	667,965	1.3%	928,288	2.0%
0	0.0%	0	0.0%	171,639	0.3%	189,928	0.4%
0	0.0%	0	0.0%	40,743	0.1%	1,882	0.0%
0	0.0%	0	0.0%	148,648	0.3%	399	0.0%
0	0.0%	0	0.0%	19,971	0.0%	0	0.0%
0	0.0%	0	0.0%	7,073	0.0%	0	0.0%
0	0.0%	0	0.0%	600,100	1.2%	677,689	1.5%
0	0.0%	0	0.0%	30,909	0.1%	59,481	0.1%
0	0.0%	0	0.0%	57,027	0.1%	0	0.0%
0	0.0%	0	0.0%	135,294	0.3%	0	0.0%
0	0.0%	0	0.0%	48	0.0%	292,458	0.6%
0	0.0%	0	0.0%	2,809	0.0%	0	0.0%
0	0.0%	0	0.0%	72,382	0.1%	14,306	0.0%
0	0.0%	0	0.0%	7,415,573	14.9%	7,290,858	15.6%
0	0.0%	0	0.0%	465,768	0.9%	625,191	1.3%
0	0.0%	0	0.0%	222,137	0.4%	430,220	0.9%
0	0.0%	14,379	100.0%	42,527,839	85.6%	39,869,984	85.4%

				Houston Airport System			
Fiscal Year 2006*		Fiscal Year 2005		Fiscal Year 2006*		Fiscal Year 2005	
Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
				140,916	0.3%	127,672	0.3%
				80	0.0%	183	0.0%
				21,738	0.0%	72,122	0.2%
				156,704	0.3%	66,058	0.1%
				194,632	0.4%	156,596	0.3%
				0	0.0%	16,441	0.0%
				70,363	0.1%	107,307	0.2%
				217,221	0.4%	193,060	0.4%
				13,291	0.0%	10,775	0.0%
Domestic only				54,113	0.1%	103,903	0.2%
				54,614	0.1%	54,456	0.1%
				4,454,118	9.0%	4,404,803	9.4%
				1,292,759	2.6%	1,039,670	2.2%
				215,816	0.4%	220,939	0.5%
				147,894	0.3%	145,599	0.3%
				30,454	0.1%	28,692	0.1%
				61,265	0.1%	69,510	0.1%
				7,125,978	14.4%	6,817,786	14.6%
0	0.0%	14,379	100.0%	49,653,817	100.0%	46,687,770	100.0%

ORIGINATING PASSENGER ENPLANEMENTS
STATISTICAL SECTION

Fiscal Year	Ellington Field	William P. Hobby Airport	George Bush Intercontinental Airport	Houston Airport System	% Change
1997	55,474	3,472,601	6,900,893	10,428,968	-1.5%
1998	57,403	3,525,131	6,964,583	10,547,117	1.1%
1999	52,325	3,513,843	8,323,914	11,890,082	12.7%
2000	46,726	3,585,312	8,839,346	12,471,384	4.9%
2001	34,044	3,564,988	9,139,616	12,738,648	2.1%
2002	35,783	3,166,701	7,934,632	11,137,116	-12.6%
2003	42,265	2,994,073	7,820,907	10,857,245	-2.5%
2004	41,500	3,103,828	8,626,935	11,772,263	8.4%
2005	7,840	3,236,719	9,321,286	12,565,845	6.7%
2006*	0	3,313,974	9,983,652	13,297,626	5.8%

* Preliminary figures for FY 2006

PERFORMANCE MEASURES
STATISTICAL SECTION

	2001	2002	2003	2004	2005	2006
Revenue per Enplaned Passenger	$ 12.92	$ 12.70	$ 13.19	$ 12.70	$ 15.97	$ 16.56
Maintenance and Operations Expenses per Enplaned Passenger	$ 5.46	$ 6.83	$ 7.50	$ 7.76	$ 9.59	$ 8.13
Debt Service per Enplaned Passenger	$ 2.23	$ 2.46	$ 3.11	$ 3.48	$ 4.81	$ 5.64
Outstanding Debt per Enplaned Passenger	$ 67.28	$ 72.07	$ 107.23	$ 101.54	$ 97.72	$ 90.80
Intercontinental Budgeted Airline Cost per Enplaned Passenger (1)	$ 4.99	$ 5.34	$ 6.47	$ 7.17	$ 10.25	$ 11.54
Intercontinental Actual Airline Cost per Enplaned Passenger (1)	$ 4.91	$ 5.59	$ 6.49	$ 6.96	$ 10.27	$ -
Hobby Budgeted Airline Cost per Enplaned Passenger (1)	$ 4.61	$ 5.02	$ 5.81	$ 7.57	$ 8.49	$ 8.52
Hobby Actual Airline Cost per Enplaned Passenger (1)	$ 4.53	$ 5.10	$ 6.32	$ 7.35	$ 8.23	$ -

(1) Airline Costs include terminal building charges, aircraft parking apron charges, and landing fees only for passenger carriers. The costs are calculated during the rates and charges process based on budget and estimated passengers. They are then recalculated, after the annual audit, during the rates and charges reconciliation process. Therefore, there is a lag in obtaining the actual cost per enplaned passenger. This is reconciliation revenue, not actual revenue booked, since the accrual is unknown and therefore not booked.

SUMMARY OF CERTAIN FEES AND CHARGES
STATISTICAL SECTION

IAH	1997	1998	1999	2000
Landing Rates (1)	$1.332	$1.276	$1.039	$1.075
Terminal Space Rentals (2)	$1.23 - $50.92	$2.29 - $50.47	$28.62 - $31.51	$20.36 - $42.31
Apron Rentals (2)			$1.428 - $1.589	$1.099 - $2.730
Parking Rates (3)				
Economy	$4.00	$4.00	$4.00	$5.00
Structured	$9.00	$9.00	$9.00	$10.00
Surface	$7.00	$7.00	$7.00	$7.00 - $9.00
Short-Term	$30.00	$30.00	$30.00	$30.00
Sure Park	--	--	--	--

HOU	1997	1998	1999	2000
Landing Rates (1)	$2.150	$2.218	$1.958	$1.931
Terminal Space Rentals (2)	$1.76 - $60.79	$1.76 - $57.44	$31.76 - $47.60	$30.62 - $48.96
Apron Rentals (2)			$1.198	$1.260
Parking Rates (3)				
Economy	$4.00	$4.00	$4.00	$5.00
Structured	$9.00	$9.00	$9.00	$10.00
Surface	--	--	--	--
Short-Term	$30.00	$30.00	$30.00	$30.00
Sure Park	--	--	--	--

(1) Per 1,000 pounds of landing weight
(2) Range per square foot
(3) Maximum per day

2001	2002	2003	2004	2005	2006
$1.269	$1.518 - $1.750	$1.651	$1.654	$3.164	$3.190
$23.96 - $53.25	$22.54 - $45.76	$24.36 - $53.83	$18.92 - $62.19	$20.69 - $92.74	$19.28 - $86.56
$.632 - $3.281	$1.133 - $2.454	$1.296 - $2.903	$1.465 - $3.094	$1.652 - $3.339	$1.759 - $3.243
$5.00	$5.00 - $6.00	$6.00	$6.00	$6.00	$6.00
$10.00	$10.00 - $12.00	$12.00	$12.00	$12.00	$13.00
$7.00 - $9.00	$7.00 - $9.00	$9.00	$9.00	$9.00	--
$30.00	$30.00	$30.00	$30.00	$30.00	--
$15.00	$15.00	$15.00	$15.00	$15.00	$15.00

2001	2002	2003	2004	2005	2006
$1.817	$1.905	$2.078	$2.232	$2.587	$2.711
$31.38 - $50.01	$35.63 - $56.68	$35.19 - $54.82	$34.41 - $60.69	$40.73 - $67.24	$42.90 - $73.02
$1.175	$1.936	$1.831	$2.019 - $3.468	$2.628 - $3.626	$2.529 - $3.722
$5.00	$5.00 - $6.00	$6.00	$6.00	$6.00	$6.00
$10.00	$10.00 - $12.00	$12.00	$12.00	$12.00	$13.00
--	--	--	--	--	--
$30.00	$30.00	$30.00	$30.00	$30.00	--
--	--	--	--	--	--

AIRCRAFT OPERATIONS AND LANDING WEIGHT
STATISTICAL SECTION

	Aircraft Operations (in thousands)			Aircraft Landed Weight (in million pounds)		
Fiscal Year	Total	Increase (Decrease)	Percentage Change	Total	Increase (Decrease)	Percentage Change
1997	768	34	4.63%	26,822	744	2.85%
1998	789	21	2.73%	28,253	1,431	5.34%
1999	796	7	0.89%	30,119	1,866	6.60%
2000	827	31	3.89%	31,495	1,376	4.57%
2001	823	(4)	-0.48%	32,083	588	1.87%
2002	790	(33)	-4.01%	30,496	(1,587)	-4.94%
2003	811	21	2.66%	30,802	306	1.00%
2004	856	45	5.55%	31,444	642	2.08%
2005	887	31	3.62%	32,488	1,044	3.32%
2006*	933	46	5.19%	32,808	320	0.98%

* Preliminary figures for FY 2006

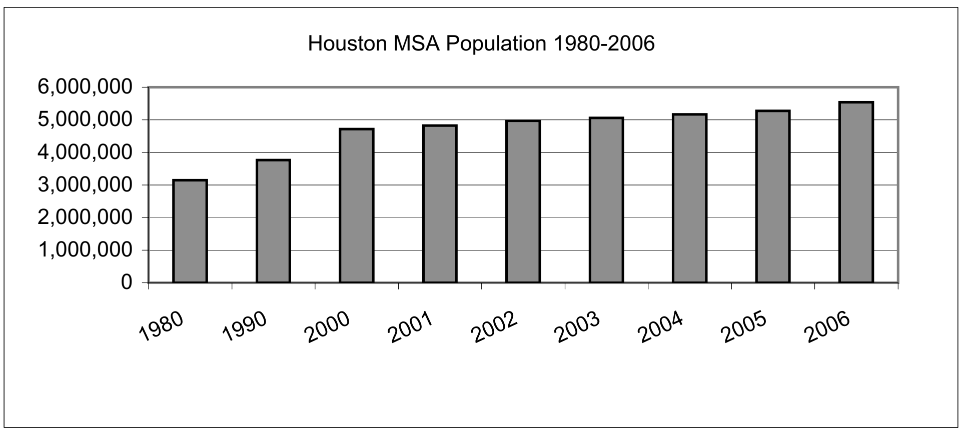
SERVICE AREA
STATISTICAL SECTION

The primary service region for the Houston Airport System, the 10-county Houston-Sugar Land-Baytown, Texas Metropolitan Statistical Area ("MSA"), has a diverse economic base and is recognized as a major national and international energy, financial, medical, transportation, retail, and distribution center. The MSA extends out two additional counties for the broader Houston-Baytown-Huntsville Combined Statistical Area ("CSA"). According to U.S. Bureau of the Census, the population estimate was 5.54 million for the MSA and 5.64 million for the CSA as of July 1, 2006. The air service region also encompasses other smaller markets such as Beaumont/Port Arthur, Victoria, Brownsville and Del Rio in Texas and Lake Charles, Louisiana as those airports only provide air service to and from Intercontinental.

Houston, the nation's fourth most populous city, is the largest in the Southwest. The Houston MSA ranks sixth in population among the nation's metropolitan areas.

Service Area Population

Year	Houston MSA Population
1980	3,148,991
1990	3,767,335
2000	4,715,407
2001	4,828,082
2002	4,967,350
2003	5,059,210
2004	5,171,071
2005	5,273,595
2006	5,539,949



Source: Texas State Data Center 1980-2005, US Census Bureau 2006

2006 Largest Private Employers Houston MSA

Aramark
Baylor College of Medicine
Compaq Computer Corporation
Continental Airlines, Inc.
H.C.A. Health
Halliburton
Hewlett-Packard Corporation
Kroger Company
Memorial Herman Healthcare Systems
Methodist Hospital System
Reliant Energy
Shell Oil Company
University of Texas, M.D. Anderson Cancer Center
University of Texas, Medical Branch at Galveston

Sources: Greater Houston Partnership; Business Houston

CITY OF HOUSTON

TEXAS

APPENDIX C

FORM OF OPINION OF CO-BOND COUNSEL

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VINSON & ELKINS L.L.P.
2300 FIRST CITY TOWER
1001 FANNIN STREET
HOUSTON, TEXAS 77002-6760

BATES & COLEMAN, P.C.
1402 ALABAMA STREET
HOUSTON, TEXAS 77004-3910

___________, 2007

WE HAVE ACTED as co-bond counsel for the CITY OF HOUSTON, TEXAS (the "City") in connection with the issuance of the CITY OF HOUSTON, TEXAS AIRPORT SYSTEM SUBORDINATE LIEN REVENUE REFUNDING BONDS, SERIES 2007B (Non-AMT) in the original aggregate principal amount of $________________ (the "Series 2007B Bonds").

The Series 2007B Bonds mature, bear interest and may be transferred and exchanged as set forth in the Series 2007B Bonds and in the ordinance of the City (the "Ordinance") and the officers pricing certificate authorizing their issuance. Capitalized terms used herein but not otherwise defined shall have the meaning assigned to them in the Ordinance.

WE HAVE ACTED as co-bond counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Series 2007B Bonds under the Constitution and laws of the State of Texas. We have not investigated or verified original proceedings, records, data or other material, but have relied solely upon the transcript of certified proceedings described in the following paragraph. We have not assumed any responsibility with respect to the financial condition or capabilities of the City or the disclosure thereof in connection with the offer and sale of the Series 2007B Bonds. Our role in connection with the City's Official Statement prepared for use in connection with the offer and sale of the Series 2007B Bonds has been limited as described therein.

IN OUR CAPACITY as co-bond counsel, we have participated in the preparation of and have examined a transcript of certified proceedings pertaining to the authorization and issuance of the Series 2007B Bonds, the bonds being refunded (the "Refunded Bonds") and notes being refunded (the "Refunded Notes," and together with the Refunded Bonds, the "Refunded Obligations") on which we have relied in giving our opinion. The transcript contains certified copies of certain proceedings of the City Council of the City; the report (the "Report") of Grant Thornton LLP, certified public accountants, verifying the sufficiency of the deposits made with the Refunded Bond Escrow Agent for the defeasance and redemption of the Refunded Bonds, the sufficiency of the deposits made with the Refunded Notes Escrow Agent for the defeasance of the Refunded Notes and the mathematical accuracy of certain computations of the yield of the Series 2007B Bonds, the Refunded Obligations and the obligations acquired with the proceeds of the Series 2007B Bonds; customary certificates of officials, agents and representatives of the City, the Refunded Bond Escrow Agent, the Refunded Note Escrow Agent and certain other public officials; and other certified showings relating to the authorization and issuance of the Series 2007B Bonds and firm banking and financial arrangements for the discharge and final payment of the Refunded Obligations. We have also examined a specimen of the form of registered bond of this issue.

BASED ON SUCH EXAMINATION, IT IS OUR OPINION THAT:

1. The transcript of certified proceedings evidences complete legal authority for the issuance of the Series 2007B Bonds in full compliance with the Constitution and laws of the State of Texas presently effective and that therefore the Series 2007B Bonds constitute valid and legally binding special obligations of the City;

2. The Series 2007B Bonds, together with all outstanding and any additional "Subordinate Lien Bonds" hereafter issued, are payable from and equally and ratably secured by a lien on the "Net Revenues" of the "Airport System" (subject to the prior and superior lien of any outstanding and any additional "Senior Lien Bonds" hereafter issued) and the "Subordinate Lien Bond Interest and Sinking Fund" and the "Subordinate Lien Bond Reserve Fund," as defined and provided in the Ordinance; and

3. Firm banking and financial arrangements have been made for the discharge and final payment of the Refunded Bonds pursuant to a Refunded Bond Escrow Agreement entered into between the City and the Refunded Bond Escrow Agent on or effective as of the date of delivery of the Series 2007B Bonds, and therefore the Refunded Bonds are deemed to be fully paid and no longer outstanding except for the purpose of being paid from funds provided for such purpose pursuant to the Refunded Bond Escrow Agreement.

4. Firm banking and financial arrangements have been made for the discharge and final payment of the Refunded Notes pursuant to a Refunded Note Escrow Agreement entered into between the City and the Refunded Note Escrow Agent on or effective as of the date of delivery of the Series 2007B Bonds, and therefore the Refunded Notes are deemed to be fully paid and no longer outstanding except for the purpose of being paid from funds provided for such purpose pursuant to the Refunded Note Escrow Agreement.

THE RIGHTS OF THE OWNERS of the Series 2007B Bonds are subject to the applicable provisions of the federal bankruptcy laws and any other similar laws affecting the rights of creditors of political subdivisions, and may be limited by general principles of equity which permit the exercise of judicial discretion. The Series 2007B Bonds are secured solely by a lien on and pledge of Net Revenues of the Airport System as described above and certain funds as provided in the Ordinance and do not constitute an indebtedness or general obligation of the City. Owners of the Series 2007B Bonds shall never have the right to demand payment of principal or interest out of any funds raised or to be raised by taxation.

THE CITY HAS RESERVED THE RIGHT TO ISSUE ADDITIONAL SENIOR LIEN BONDS, SUBORDINATE LIEN BONDS and inferior lien obligations, subject to the restrictions contained in the Ordinance, secured by liens on the Net Revenues that are prior and superior to, on a parity with, or junior and inferior to, respectively, the lien on Net Revenues securing the Series 2007B Bonds.

IT IS OUR FURTHER OPINION THAT:

1. Interest on the Series 2007B Bonds is excludable from gross income for federal income tax purposes under existing law; and

2. The Series 2007B Bonds are not "private activity bonds" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), and interest on the Series 2007B Bonds is not subject to the alternative minimum tax on individuals and corporations, except in the case of a corporate taxpayer (other than an S corporation, a regulated investment company, a REIT, a REMIC or a FASIT), interest on the Series 2007B Bonds will be included in such corporation's "adjusted current earnings" for purposes of computing its alternative minimum tax liability under existing law.

In providing such opinions, we have relied on the Report and on representations of the City, the City's co-financial advisors and the Underwriter with respect to matters solely within the knowledge of the City, the City's co-financial advisors and the Underwriter, respectively, which we have not independently verified, and we have assumed continuing compliance with the covenants of the City pertaining to those sections of the Code that affect the exclusion from gross income of the interest on the Series 2007B Bonds for federal income tax purposes. If the Report or such representations are determined to be inaccurate or incomplete, or if the City fails to comply with the foregoing described covenants, interest on the Series 2007B Bonds could become taxable from the date of their original delivery, regardless of the date on which the event causing such taxability occurs.

Except as stated above, we express no opinion as to any federal, state or local tax consequences resulting from the ownership of, receipt or accrual of interest on or disposition of the Series 2007B Bonds.

Owners of the Series 2007B Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations, and individuals otherwise qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the new “branch profits tax” on their effectively-connected earnings and profits (including tax-exempt interest such as interest on the Series 2007B Bonds).

The opinions set forth above are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement these opinions to reflect any facts or circumstances that may hereafter come to our attention or to reflect any changes in law that may hereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service (the “Service”); rather, such opinions represent our legal judgment based upon our review of existing law and in reliance upon the representations and covenants referenced above that we deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given whether or not the Service will commence an audit of the Series 2007B Bonds. If an audit is commenced, in accordance with its current published procedures, the Service is likely to treat the City as the taxpayer. We observe that the City has covenanted in the Ordinance not to take any action, or omit to take any action within its control, that if taken or omitted, respectively, may result in the treatment of interest on the Series 2007B Bonds as includable in gross income for federal income tax purposes.

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APPENDIX D

SUMMARY OF SCHEDULES RELATED TO CONTINUING DISCLOSURE OF INFORMATION

Schedule 1	Passenger Statistics (including Schedule 1A — Originating and Connecting Enplaned Passengers for the Houston Airport System
Schedule 2	Airline Market Shares
Schedule 3	Total Aircraft Operations and Aircraft Landed Weight
Schedule 4	Selected Financial Information
Schedule 5	Summary of Certain Fees and Charges
Schedule 6	Houston Airport System Debt Service Requirements Schedule
Schedule 7	Houston Airport System Outstanding Debt
Schedule 8*	Municipal System Pension Plan Assets, Liabilities, and Unfunded Actuarial Accrued Liability

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* The City agrees and is obligated to update Schedule 8 only to the extent that the City receives updated actuarial reports from the board of the Municipal Employees Pension System (the "Pension System"). The City is not empowered to require the board of the Pension System to obtain updated actuarial reports. The Pension System will periodically receive additional actuarial reports with regard to the City's pension plans, to the extent required under State law or requested by the board of the Pension System. Accordingly, an updated Schedule 8 may not be available in every annual continuing disclosure filing.

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APPENDIX E

DEPOSITORY TRUST COMPANY

The information in this APPENDIX E describes the securities clearance procedures of The Depository Trust Company ("DTC") in the United States. The information in this APPENDIX concerning DTC has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy of such information.

The Depository Trust Company

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for each maturity of each issue of 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 2.2 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, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other 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.

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, distributions, and dividend 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 the 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, the 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, distributions, and dividend 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 the Paying Agent/Registrar, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

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

The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

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.

APPENDIX F

FORM OF MUNICIPAL BOND INSURANCE POLICY

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FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

Municipal Bond
New Issue Insurance Policy

Issuer:	**Policy Number:**
	Control Number: 0010001
Bonds:	**Premium:**

SPECIMEN

Financial Guaranty Insurance Company ("Financial Guaranty"), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to U.S. Bank Trust National Association or its successor, as its agent (the "Fiscal Agent"), for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a Bond, the stated date for payment of interest. "Nonpayment" in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all

FGIC is a registered service mark used by Financial Guaranty Insurance Company under license from its parent company, FGIC Corporation.

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212-312-3000
T 800-352-0001

Municipal Bond
New Issue Insurance Policy

---

principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

SPECIMEN

President

Effective Date: **Authorized Representative**

U.S. Bank Trust National Association, acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

Authorized Officer

FGIC

Financial Guaranty Insurance Company
125 Park Avenue
New York, NY 10017
T 212·312·3000
T 800·352·0001

Endorsement

To Financial Guaranty Insurance Company Insurance Policy

Policy Number:	**Control Number:** 0010001

SPECIMEN

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date: **Authorized Representative**

Acknowledged as of the Effective Date written above:

Authorized Officer
U.S. Bank Trust National Association, as Fiscal Agent

FGIC is a registered service mark used by Financial Guaranty Insurance Company under license from its parent company, FGIC Corporation.

APPENDIX G

ECONOMIC AND DEMOGRAPHIC CHARACTERISTICS

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HOUSTON–SUGAR LAND–BAYTOWN MSA POPULATION ESTIMATES
1997-2006

Calendar Year	Population Estimates (In Thousands)	Annual % Change
2006	5,539.94	3.4%
2005	5,352.57	0.4%
2004	5,332.77	4.1%
2003	5,116.72	2.3%
2002	5,001.27	2.7%
2001	4,863.87	2.5%
2000	4,742.16	2.1%
1999	4,644.53	2.3%
1998	4,535.98	2.4%
1997	4,427.40	-

Source: Population Division, U.S. Census Bureau.

HOUSTON POPULATION ESTIMATES (WITHIN THE CITY LIMITS)
1997-2006

Year[(a)]	Population Estimates (In Thousands)	Annual % Change
2006	2,144.5	1.2%
2005	2,118.0	1.4%
2004	2,087.5	1.6%
2003	2,054.2	1.4%
2002	2,026.0	1.3%
2001	2,000.5	1.2%
2000	1,977.2	6.6%
1999	1,846.0	0.9%
1998	1,829.1	1.2%
1997	1,807.4	-

Source: Population Estimates Program, Population Division, U.S. Census Bureau (1997-2006).

(a) Figures are as of July of each year.

HOUSTON CONSUMER PRICE INDEX
ALL URBAN CONSUMERS 1997-2006

Calendar Year		Annual % Change
2006	180.6	2.8
2005	175.6	3.6
2004	169.5	3.5
2003	163.7	2.8
2002	159.2	0.3
2001	158.8	3.0
2000	154.2	3.7
1999	148.7	1.3
1998	146.8	1.0
1997	145.4	1.9

Source: University of Houston, Center for Public Policy, May, 2007.

NON-AGRICULTURAL WAGE AND SALARY EMPLOYMENT
(SEASONALLY ADJUSTED) AND AVERAGE NUMBER OF JOBS
(in thousands)
1997-2006

Calendar Year	**Annual Average** (thousands)	**Percent Change**
2006	2,434.0	4.1
2005	2,337.1	2.6
2004	2,278.7	0.7
2003	2,262.9	-0.6
2002	2,277.4	-0.2
2001	2,282.4	1.7
2000	2,243.5	2.4
1999	2,191.3	1.6
1998	2,155.9	5
1997	2,054.1	4.2

Source: University of Houston, Center for Public Policy, Institute for Regional Forecasting, May 2007

HOUSTON PMSA

UNEMPLOYMENT RATE
(NOT SEASONALLY ADJUSTED)
% UNEMPLOYED
1997-2006

Calendar Year	Annual Average %
2006	5.00
2005	5.50
2004	6.20
2003	6.80
2002	6.00
2001	4.70
2000	4.40
1999	4.70
1998	4.40
1997	5.30

Source: University of Houston, Center for Public Policy, May 2007

PORT OF HOUSTON TONNAGETOTAL CARGO1996-2005

Calendar Year	Short Tons
2005*	211,700,000*
2004	202,000,000
2003	190,923,145
2002	177,560,718
2001	185,050,168
2000	186,567,246
1999	158,828,203
1998	169,070,334
1997	165,456,278
1996	148,182,876

*Estimated

Source: Port of Houston Authority

HOUSTON CMSA
ANNUAL HOUSING STARTS
1997-2006

Calendar Year	Single Family	Multi-Family	Total
2006	50,016	13,834	63,850
2005	51,085	11,080	62,165
2004	45,039	10,858	55,897
2003	41,995	16,761	58,756
2002	34,640	12,401	47,041
2001	34,311	7,183	41,494
2000	31,120	7,590	38,710
1999	27,270	11,990	39,260
1998	29,030	18,280	47,310
1997	22,880	11,560	34,440

Source: CDS Research and MetroStudy

GREATER HOUSTON AREA
APARTMENT OCCUPANCY RATES
1997-2006

Calendar Year	Occupancy Rate
2006	88.10
2005	90.60
2004	85.80
2003	87.10
2002	89.70
2001	91.50
2000	90.70
1999	89.40
1998	90.50
1997	91.10
1996	90.00

Source: Apartment Data Services, Inc. (1996-1997) and CB Richard Ellis (1998-2006)

HOUSTON HOTEL OCCUPANCY RATES
1997-2006

Calendar Year	Average Occupancy Rate
2006	55.80%
2005	63.10
2004	61.40
2003	60.40
2002	63.20
2001	68.90
2000	65.60
1999	63.60
1998	66.70
1997	68.40

Source: The PKF Consulting/Hospitality Advisory Services

CITY OF HOUSTON BUILDING PERMITS
1997-2006

New Non-Residential[(a)]

Calendar Year	Number of Permits Issued	Dollar Value (In Thousands)
2006	2944	$1,342,131
2005	3,231	1,150,103
2004	1,218	673,381
2003	3,217	731,725
2002	1,976	864,773
2001	3,291	1,379,047
2000	3,418	891,856
1999	3,620	1,133,165
1998	3,370	1,227,234
1997	3,011	452,897

[(a)] Privately Owned

Source: City of Houston, Public Works and Engineering

CITY OF HOUSTON BUILDING PERMITS
1997-2006
New Residential[a]

	Single Family		Multi-Family	
Calendar Year	Number of Permits Issued	Dollar Value (In Thousands)	Number of Permits Issued	Dollar Value (In Thousands)
2006	7628	$1,330,846	538	$588,083
2005	7296	1,152,592	274	359,663
2004	5958	943,913	440	344,397
2003	5140	819,294	472	510,474
2002	4152	666,003	696	524,060
2001	4320	681,451	308	323,373
2000	4655	964,656	339	238,869
1999	4064	657,106	323	259,005
1998	3940	610,412	912	551,691
1997	3523	523,623	488	279,105

[a] Privately Owned

Source: City of Houston, Public Works and Engineering.

HOUSTON PMSA
GENERAL PURPOSE OFFICE SPACE ACTIVITY[a]
1996-2006

Calendar Year	Net Rentable Area[b]	Leasing Activity[c] (Millions of sq feet)	Net Absorbtion[d]	Annual Vacancy Rate	Average Rents (Per square foot)[e]
2006	178.21	[f]	0.3	14.48	18.09
2005	177.88	[f]	1.2	14.46%	$17.78
2004	178.14	[f]	0.2	16.35	17.81
2003	147.31	[f]	0.8	16.44	21.01
2002	147.23	[f]	1.1	16.55	20.66
2001	143.40	[f]	1.3	13.20	22.81
2000	143.57	[f]	2.7	13.89	18.81
1999	143.93	[f]	1.6	13.00	17.58
1998	156.07	[f]	1.8	10.26	18.04
1997	156.56	14.1	8.4	11.13	14.30

[a] Based on buildings greater that 29,999 square feet. (Excludes single tenant government-owned and medical office buildings)

[b] Decrease in 1999 due to change in the market base (37 single tenant buildings

© Leasing activity shows the total number of square feet leased each year, excluding renewals of existing leases.
[d] Millions of square feet net absorption is the difference between the total number of square feet that are leased (excluding renewals of leases) and the total number of square feet that have become vacant in the year.

[e] Average asking rental rates are quoted on a gross basis.

[f] This statistic was discontinued by CB Richard Ellis.

Source: CB Richard Ellis, The Outlook Report

APPENDIX H

THE ORDINANCE - SUMMARY AND GLOSSARY OF TERMS

SUMMARY OF SELECTED PROVISIONS

The following are summaries of certain provisions of the Ordinance which have not been previously summarized or set forth under the captions "THE BONDS" or "AMENDMENTS OF OUTSTANDING BOND ORDINANCES."

Funds

Establishment of Funds. The Ordinance requires that the following listed eight special funds be established, maintained and accounted for so long as there are any Senior Lien Bonds Outstanding or Subordinate Lien Bonds Outstanding: the Revenue Fund; the Senior Lien Bond Interest and Sinking Fund; the Senior Lien Bond Reserve Fund; the Subordinate Lien Bond Interest and Sinking Fund; the Subordinate Lien Bond Reserve Fund; the Operation and Maintenance Reserve Fund; the Renewal and Replacement Fund; and the Airports Improvement Fund.

The Ordinance provides that the Revenue Fund, the Operation and Maintenance Reserve Fund, the Renewal and Replacement Fund and the Airports Improvement Fund shall be maintained as separate funds or accounts on the books of the City and all amounts credited to such Funds shall be maintained in an official depository bank of the City or in a trustee bank designated by the City. The Ordinance further provides that the Senior Lien Bond Interest and Sinking Fund and the Senior Lien Bond Reserve Fund, each of which constitutes a trust fund for the Owners of the Senior Lien Bonds, and the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund, each of which constitutes a trust fund for the Owners of the Subordinate Lien Bonds, shall be maintained at an official depository bank of the City separate and apart from all other funds and accounts of the City.

Flow of Funds. All Gross Revenues of the Houston Airport System shall be deposited, as received, into the Revenue Fund. In addition, the City may deposit into the Revenue Fund any Federal Payments, provided that, so long as such Federal Payments are excluded from the definition of Gross Revenues, such Federal Payments shall be applied solely to the payment of Operation and Maintenance Expenses. Moneys from time to time credited to the Revenue Fund shall be applied in the following order of priority:

(1) First, to pay and to provide by encumbrance for the payment of all current Operation and Maintenance Expenses;

(2) Second, to transfer all amounts to the Senior Lien Bond Interest and Sinking Bond Fund required by any ordinance authorizing the issuance of Senior Lien Bonds;

(3) Third, to transfer all amounts to the Senior Lien Bond Reserve Fund required by any ordinance authorizing the issuance of Senior Lien Bonds, including transfers to pay all reimbursement obligations under any reserve fund surety policies obtained with respect to Senior Lien Bonds and to enable the City to reestablish therein the Reserve Fund Requirement for Senior Lien Bonds;

(4) Fourth, so long as any Subordinate Lien Bonds remain Outstanding, to transfer all amounts to the Subordinate Lien Bond Interest and Sinking Fund as shall be necessary so that the balance therein equals the Debt Service Requirements on all Subordinate Lien Bonds accrued to the end of the current month plus such amounts which will enable the City to pay when due all expenses of providing for the full and timely payment of the principal of, premium, if any, and interest on the Subordinate Lien Bonds, including without limitation, all fees charged or incurred in connection with bond insurance, letters of credit, standby bond purchase agreements, or other credit or liquidity facilities, remarketing agreements, interest rate indexing agreements and tender agent agreements obtained or entered into by the City in connection with the Subordinate Lien Bonds;

(5) Fifth, in any month in which the Subordinate Lien Bond Reserve Fund contains less than the Reserve Fund Requirement for the Subordinate Lien Bonds (or so much thereof as shall then be required to be therein if the City has elected to accumulate such reserve requirement amount for any series of Additional Subordinate Lien Bonds), then on or before the last business day of such month, to transfer to the Subordinate Lien Bond Reserve Fund, in equal monthly

installments, amounts sufficient to enable the City to pay all reimbursement obligations under the Subordinate Lien Bond Reserve Fund Surety Policy within a 12 month period and such additional amounts as shall be sufficient to enable the City within a 12 month period to reestablish therein the Reserve Fund Requirement for Subordinate Lien Bonds;

(6) Sixth, to transfer all amounts necessary to provide for the payment, and/or to provide reserves for the payment, of principal of, premium, if any, and interest on any Inferior Lien Bonds to the appropriate funds or accounts established for such purpose or required to be maintained by any ordinance authorizing such Inferior Lien Bonds;

(7) Seventh, on or before the last business day of each month, to transfer to the Operation and Maintenance Reserve Fund, to the extent funds are available therefor, an amount required to reestablish the required balance therein, which in the Ordinance the City has covenanted to maintain in an amount at least equal to two months current Operation and Maintenance Expenses (which amount shall annually be redetermined by the Director of the Houston Airport System at the time he submits his recommended budget for the Houston Airport System based upon either his recommended budget for Operation and Maintenance Expenses or his estimate of the then current Houston Airport System budget or the actual Operation and Maintenance Expenses for the previous Fiscal Year);

(8) Eighth, on or before the last business day of each month in which the Renewal and Replacement Fund contains less than the Renewal and Replacement Fund Requirement and after making all required payments and provision for payment of Operation and Maintenance Expenses and all prior transfers, to transfer from the Revenue Fund to the Renewal and Replacement Fund, to the extent funds are available therefor, an amount equal to 1/12th of the deficiency (being the amount by which the Renewal and Replacement Fund Requirement exceeded the unappropriated balance therein) as of the last day of the previous Fiscal Year and, at the discretion of the City, to pay directly from the Revenue Fund any other costs that could be paid from amounts on deposit in the Renewal and Replacement Fund until such time as the Renewal and Replacement Fund Requirement has again been accumulated in the Renewal and Replacement Fund; and

(9) Ninth, the balance shall be transferred to the Airports Improvement Fund.

Senior Lien Bond Interest and Sinking Fund. After making all required payments and provision for payment of Operation and Maintenance Expenses and all prior transfers, the City shall transfer into the Senior Lien Bond Interest and Sinking Fund, in such amounts, and on such dates as may be provided in the ordinances authorizing the issuance of the Senior Lien Bonds, to provide for the full and timely payment of all principal of, interest on and premiums, if any, on all such Senior Lien Bonds and all expenses of providing for their full and timely payment in accordance with their terms including without limitation, all fees charged or incurred in connection with bond insurance, letters of credit, lines of credit, standby bond purchase agreements, or other credit or liquidity facilities, remarketing agreements, interest rate indexing agreements and tender agreements obtained or entered into by the City in connection with any Senior Lien Bonds.

Senior Lien Bond Reserve Fund. After making all required payments and provision for payment of Operations and Maintenance Expenses and after making all required transfers, the City shall transfer into the Senior Lien Bond Reserve Fund, on such date and in such amounts (but not to exceed in any month one-twelfth (1/12th) of the maximum Debt Service Requirements scheduled to occur in any future Fiscal Year on all Senior Lien Bonds then Outstanding) as may be provided in the ordinances authorizing the issuance of the Senior Lien Bonds.

Subordinate Lien Bond Interest and Sinking Fund. Moneys credited to the Subordinate Lien Bond Interest and Sinking Fund shall be used solely for the purpose of paying principal (at maturity or prior redemption or to purchase Subordinate Lien Bonds issued as term bonds in the open market to be credited against mandatory redemption requirements), interest and redemption premiums on the Subordinate Lien Bonds, plus all bank charges and other costs and expenses relating to such payment, including those set forth in (4), above. On or before each principal and/or interest payment date on the Subordinate Lien Bonds, the City shall transfer from the Subordinate Lien Bond Interest and Sinking Fund to the Paying Agent/Registrar an amount equal to the principal of, premium, if any, and interest on the Subordinate Lien Bonds on such date.

Subordinate Lien Bond Reserve Fund. The Subordinate Lien Bond Reserve Fund shall be used to pay the principal of and interest on the Subordinate Lien Bonds at any time when there is not sufficient money available in the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policy), and to pay reimbursements under the Subordinate Lien Bond Reserve Fund Surety Policy. Such fund may be used to make the final payments for the retirement or defeasance of all Subordinate Lien Bonds then Outstanding.

Operation and Maintenance Reserve Fund. Amounts from time to time credited to the Operation and Maintenance Reserve Fund may be used at any time first, to pay for any Operation and Maintenance Expenses for which amounts are not otherwise available in the Revenue Fund; second, to pay any costs or expenses payable from the Renewal and Replacement Fund for which there are insufficient amounts in the Renewal and Replacement Fund; and/or third, to the extent such amounts are available, to be transferred to the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund, the Subordinate Lien Bond Reserve Fund or any similar fund created to provide for the payment, or reserves for the payment, of Senior Lien Bonds to the extent of any deficiency therein.

Renewal and Replacement Fund. Amounts from time to time credited to the Renewal and Replacement Fund may be used at any time first, to pay for any costs of replacing depreciable property and equipment of the Houston Airport System and making repairs, replacements or renovations of the Houston Airport System; second, to pay any Operation and Maintenance Expenses for which insufficient amounts are available in the Revenue Fund and the Operation and Maintenance Reserve Fund; and third, to the extent any amounts are remaining to be transferred to the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund, the Subordinate Lien Bond Reserve Fund or any similar fund created to provide for the payment, or reserves for the payment, of Senior Lien Bonds to the extent of any deficiency therein.

Airports Improvement Fund. Amounts credited to the Airports Improvement Fund may be used only for lawful Houston Airport System purposes, including without limitation, to pay for any capital expenditures or to pay costs of replacing any depreciable property or equipment of the Houston Airport System, to make any major or extraordinary repairs, replacements or renewals of the Houston Airport System, to acquire land or any interest therein, to pay any lease or contractual obligations not paid as Operation and Maintenance Expenses and to make any transfers required to cure any deficiencies in the Renewal and Replacement Fund; provided, however, that at any time any unappropriated, unbudgeted, unreserved or otherwise unencumbered amounts in the Airports Improvement Fund exceeds (1) the unfunded amount of the Houston Airport System capital improvements program for the next 24 months or (2) $50,000,000, whichever is greater, such excess amount may be used by the City for any lawful purpose. At present, under Texas law and terms and provisions of federal funds received by the City, the City may not lawfully use such excess for other than lawful Houston Airport System purposes.

Annual Budget

The Ordinance provides that prior to the commencement of each Fiscal Year, the Director of the Houston Airport System is required to prepare and deliver to the Mayor, for submission to the City Council of the City, a recommended annual budget for the Houston Airport System in compliance with the definitional and accounting requirements contained in the Ordinance. The City is required to adopt annual budgets for the Houston Airport System each Fiscal Year, each of which shall contain an estimate of revenues and only such budgeted expenditures as will produce Net Revenues of the Houston Airport System in an amount not less than the Net Revenues of the Houston Airport System necessary to comply with the Rate Covenant. The Ordinance requires that total Operation and Maintenance Expenses will not exceed total expenditures authorized for such purposes by the budget, as it may from time to time be amended.

Discharge by Deposit

The Ordinance provides that the City may discharge its obligation to the Owners of any or all of the Bonds or Additional Subordinate Lien Bonds to pay principal, interest and redemption premium (if any) thereon by depositing with the Paying Agent/Registrar cash in an amount equal to the principal amount and redemption premium, if any, of such Subordinate Lien Bonds plus interest thereon to the date of maturity or redemption; or by depositing either with the Paying Agent/Registrar or with any national banking association with capital and surplus in excess of $100,000,000, pursuant to an escrow or trust agreement to which the Paying Agent/Registrar is a party, cash and/or any obligation authorized under Texas law to be deposited for the payment or redemption of the Bonds in principal amounts and maturities and bearing interest at rates sufficient, based upon a verification report of an independent nationally recognized certified public accountant, to provide for the timely payment of the principal amount and redemption premium, if any, of such Subordinate Lien Bonds, including the Bonds, plus interest thereon to the date of maturity or redemption. Upon such deposit, such Subordinate Lien Bonds, including the Bonds, shall no longer be regarded as being Outstanding or unpaid. The City shall give irrevocable instructions to the Paying Agent/Registrar to give notice of redemption of said Subordinate Lien Bonds, including the Bonds, to be redeemed in the manner required in the ordinance or ordinances authorizing such Subordinate Lien Bonds, including the Bonds. For any Subordinate Lien Bonds not to be redeemed or paid in full within the next succeeding 60 days from the date of deposit provided for any such ordinance, the City shall give the Paying Agent/Registrar irrevocable instructions to mail, by certified mail, a notice (containing certain specified information) to the Registered Owner of each such Subordinate Lien Bond that the deposit required by such ordinance has been made and that said Subordinate Lien Bonds are deemed paid in accordance with such ordinance and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal amount and redemption premium (if any) on such Subordinate Lien Bonds plus interest thereon to the date of maturity or redemption. Any failure, error or delay in giving such notice shall not affect the defeasance of such Subordinate Lien Bonds, including the Bonds.

The Amendments

Gross Revenues. The Ordinance amends the term Gross Revenues to expressly exclude any revenues derived from Excluded Fees and Charges. See "AMENDMENTS TO PRIOR ORDINANCES" and "APPENDIX H – The Ordinance – Summary and Glossary of Terms – Glossary of Terms" for additional information on the definition of Gross Revenues.

Debt Service Requirements. The Ordinance amends the definition of Debt Service Requirements to exclude any or all of the interest on or principal of Houston Airport System Bonds which has been irrevocably committed to be paid from Houston Airport System funds other than Net Revenues, including, but not limited to, Grants, PFC Revenues or Excluded Fee and Charge Revenues. See "AMENDMENTS TO PRIOR ORDINANCES" and "APPENDIX H – The Ordinance – Summary and Glossary of Terms – Glossary of Terms" for additional information on the definition of Debt Service Requirements.

Conditions Precedent to the Effectiveness of the Amendments. The Amendments to the definition of Gross Revenues and Debt Service Requirements will not become effective until the date on which they have become incorporated into every ordinance pursuant to which Houston Airport System Bonds are then Outstanding (the "Amendment Effective Date"). The Amendment Effective Date will not occur prior to the satisfaction of certain conditions for each series of Bonds Outstanding as described below.

(i) With regard to the Series 2007 Bonds, the Owners of the Series 2007 Bonds shall be deemed to have consented to the Amendments. Therefore, all conditions to the effectiveness of the Amendments shall be considered satisfied for the Series 2007 Bonds as of the Issuance Date.

(ii) With regard to the Series A Commercial Paper Notes and Series B Commercial Paper Notes, the conditions for the effectiveness of the Amendments shall be deemed satisfied upon either (a) termination of the Series A and Series B Commercial Paper programs or (b) certification by the City that the requirements for amending the ordinance authorizing the issuance of the Series A Commercial Paper Notes and the Series B Commercial Paper Notes have been met.

(iii) With respect to the City's Series 1998 Bonds, Series 2000 Bonds, Series 2001 Bonds, Series 2002 Bonds and the Series 2005A Bonds the conditions for the effectiveness of the Amendments shall be deemed satisfied upon either (a) payment in full or defeasance of such series of bonds so that they are no longer outstanding or (b) certification by the City that the requirements for amending the ordinances authorizing such series of bonds have been met.

(iv) With respect to each series of additional bonds issued after the issuance of the Series 2007 Bonds, the ordinance authorizing such series shall include the terms of the Amendments.

The Amendment Effective Date will be evidenced by a certificate executed by the City to the effect that all of the preceding conditions have been satisfied. The City will not exercise its rights under the Amendments contained in the Ordinance until the Amendment Effective Date.

Other Changes to the Ordinance

Excluded Fee and Charge Revenues. The Ordinance adds the term Excluded Fee and Charge Revenues, which is defined to mean all income and revenues (i) derived from fees and charges imposed by City ordinance adopted after July 1, 2007 and declared in such ordinance to constitute fees and charges of the kind that will generate Excluded Fee and Charge Revenues and (ii) relate to periods after the Amendment Effective Date (as defined below). Such Excluded Fee and Charge Revenues may be authorized pursuant to any federal, state or local authority and may include, but not be limited to, any charge or fee relating to providing, enhancing or maintaining security for the Houston Airport System or any fee or charge imposed on any commercial cargo activity of the Houston Airport System.

Excluded Fee and Charge Revenues Obligations. The Ordinance provides that the City reserves the right to issue or incur, for any lawful Houston Airport System purpose bonds, notes or other obligations secured in whole or in part by a lien on all or any designated portion of the Excluded Fee or Charge Revenues, and states that such obligations may be further secured by any other source of payment lawfully available for such purposes.

Treatment of PFC Revenues Under the Ordinance. The definition of Gross Revenues has historically excluded passenger facility charges; consequently, such revenues are not pledged to any Bonds. PFC Revenues. In the Ordinance, the City clarified that it has reserved the right to commit, pledge, encumber or otherwise use all or any portion of PFC Revenues solely for the purposes of the Houston Airport System, including, but not limited to: (i) committing all or any portion of PFC Revenue to the payment of debt service for any Houston Airport System Bonds; (ii) pledging all or any portion of PFC Revenues to the payment of certain obligations secured by a pledge of all or a designated portion of PFC Revenues; or (iii) using all or any portion of PFC Revenues for payment of certain projects of the Houston Airport System or other purposes that benefit the Houston Airport System.

Prior to committing or pledging PFC Revenues for the benefit of the Houston Airport System, the City must adopt a supplemental ordinance to determine (a) the eligible PFC Revenues available for such purpose and the manner by which such available PFC Revenues may be committed or pledged for the purposes described in (i) and (ii) above; (b) the disposition of available PFC Revenues during a given Fiscal Year(s); (c) the flow of funds in respect to available PFC Revenues for the purposes described in (i) and (ii) above; and (d) any determinations, findings, appropriations, reservations, and covenants that are appropriate and necessary to give effect to such Supplemental Ordinance. Any Supplemental Ordinances must be accompanied by an opinion of bond counsel to the Houston Airport System to the effect that the Supplemental Ordinance is not in conflict with any provisions or covenants of this Ordinance or any other ordinance authorizing the issuance of Senior Lien Bonds or Subordinate Lien Bonds. To date, the City has not adopted a Supplemental Ordinance committing or pledging the PFC Revenues.

The Ordinance provides that there is to be excluded from Debt Service Requirements amounts irrevocably committed to make payments of any portion or all of the interest on or principal of Bonds. Such irrevocable commitments may be provided from any available Houston Airport System moneys other than Net Revenues, including PFC Revenues.

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GLOSSARY OF TERMS

The following terms are defined in the Ordinance or elsewhere in the Official Statement. Proposed amendments are underlined and designated with an asterisk. See "Amendments of Outstanding Bond Ordinances" for summaries of certain amendment provisions of the Ordinance.

"Act" shall mean, collectively, Chapters 1201, 1207, 1371, and 1503, Texas Government Code, as amended.

"Additional Senior Lien Bonds" shall mean the additional senior lien revenue bonds, notes and obligations permitted to be issued by the City pursuant to the Ordinance.

"Additional Subordinate Lien Bonds" shall mean the additional subordinate lien revenue bonds, notes and obligations permitted to be issued by the City pursuant to the Ordinance.

"Airport Management Consultant" shall mean a nationally recognized independent firm, person or corporation having a widely known and favorable reputation for special skill, knowledge and experience in methods of development, operation, financing and management of airports of approximately the same size as the properties constituting the Houston Airport System.

"Amendment Effective Date" shall mean the date on which the Amendments have become incorporated into every ordinance pursuant to which Bonds are then Outstanding.

"APM" means an automated people mover.

"Authorized Representative" shall mean, with respect to the Bonds, the person from time to time holding the office of the City Controller; or the deputy controller, or any officer or manager in the Debt Section of the Office of the City Controller designated in writing by the City Controller to serve in such capacity, with a copy of such written designation provided to Paying Agent/Registrar.

"Aviation Director" shall mean the Director of the Houston Airport System (a department of the City which operates the Airport System), or his successor or person acting in such capacity.

"Bond Insurance Policy" shall mean the municipal bond insurance policy or policies issued by the Bond Insurer that guarantees payment of the principal of and interest on the Series 2007 Bonds.

"Bond Purchase Fund" means the fund and accounts therein established with a Tender Agent pursuant to the Ordinance.

"Bondholder" or "Holder" means, as of any time, the registered owner of any Series 2007 Bonds as shown in the Register kept by the Paying Agent/Registrar as bond registrar.

"Bonds" shall mean any or all of the Senior Lien Bonds or the Subordinate Lien Bonds, or both, as the context may indicate, including Completion Bonds and Short-Term/Demand Obligations (including, with respect to the Series 2005A Bonds, Bank Bonds).

"Central FIS" means central federal inspection services facility.

"CFC" means customer facility charge.

"City" shall mean the City of Houston, Texas, and, where appropriate, the City Council thereof, or any successor thereto as the owner and operator of the Houston Airport System.

"CMSA" means Consolidated Metropolitan Statistical Area.

"Co-Bond Counsel" means initially, Vinson & Elkins L.L.P. and Bates & Coleman, P.C., and thereafter any attorney at law or firm(s) of attorneys selected by the City of nationally recognized standing in matters pertaining to the validity of and the tax-exempt nature of interest on bonds issued by states and their political subdivisions, duly admitted to the practice of law before the highest court of any state of the United States of America.

"Completion Bonds" shall mean each series of Bonds permitted to be issued by the City pursuant to the Ordinance.

"Credit Agreement" shall mean any agreement between the City and a third party financial institution pursuant to which such third party financial institution issues a letter of credit, municipal bond insurance policy, line of credit, standby bond purchase agreement, surety policy, surety bond or other guarantee for the purpose of enhancing the creditworthiness or liquidity of any of the City's obligations pursuant to any Bonds or Qualified Hedge Agreements and in consideration for which the City may agree to pay, but solely from Net Revenues as provided herein, (i) periodic payments for the availability of such Credit Agreement and/or (ii) reimbursements or repayments of any amounts advanced under such Credit Agreement, together with interest and other stipulated costs and charges related to such amounts advanced. Obligations of the City pursuant to a Credit Agreement shall be deemed to be, and shall be included within, the Debt Service Requirements for the series of Bonds to which the Credit Agreement relates. Further, obligations of the City to make payments under a Credit Agreement as reimbursements or repayments of amounts paid or advanced under such Credit Agreement for interest on or principal of any Bonds (including interest and other stipulated costs and charges related to such amounts advanced) shall be deemed to be payments of interest on or principal of such Bonds. Each Credit Agreement shall be deemed to be a part of the Series 2007 Bonds of the series to which it relates for the purpose of securing its payment or repayment by the pledge of Net Revenues as provided in Articles V, VI, and VII of the Ordinance. However, issuers of Credit Agreements shall not be treated as Owners of Bonds for purposes of any voting rights to approve amendments or to direct the exercise of any remedies under the Ordinance.

"Debt Service Requirements" shall mean, as of any date of calculation, an amount equal to the sum of the following for any period and with respect to all or any portion of the Bonds:

A. Current interest scheduled to accrue during such period on such Bonds, except to the extent that provision for the payment of such interest has been made by (i) appropriating for such purpose amounts sufficient to provide for the full and timely payment of such interest either from proceeds of Bonds, from interest earned or to be earned thereon, from other Houston Airport System funds other than Net Revenues, or from any combination of such sources and (ii) depositing such amounts (except in the case of interest to be earned, which shall be deposited as received) into a fund or account for capitalized interest, the proceeds of which are required to be transferred as needed into the Senior Lien Bond Interest and Sinking Fund or the Subordinate Lien Bond Interest and Sinking Fund, as the case may be, plus

B. That portion of the principal amount of, or compounded interest on, such Bonds scheduled to be payable on or before the next July 1 (either at maturity or by reason of scheduled mandatory redemptions, but after taking into account all prior optional and mandatory Bond redemptions) which would accrue if such principal amount were deemed to accrue daily in equal amounts from the next preceding July 1;

*<u>less</u> C. <u>In addition to the amounts credited under paragraph A above, any portion or all of the interest on or principal of Bonds which has been irrevocably committed to be paid from other Airport System funds other than Net Revenues, including, but not limited to, PFC Revenues or Excluded Fee and Charge Revenues</u>.

provided, however, that the following rules shall apply to the computation of Debt Service Requirements on certain series of Short-Term/Demand Obligations and on any series of Bonds bearing interest at a floating or variable rate:

(i) For any series of Short-Term/Demand Obligations issued pursuant to a commercial paper program or similar program, Debt Service Requirements shall be computed on the assumption that the principal amount shall continuously be refinanced under such program and remain outstanding until the first Fiscal Year for which interest on such Short-Term/Demand Obligations has not been capitalized or otherwise funded or provided for, at which time (which shall not be beyond the term of such program) it shall be assumed that the outstanding principal amount thereof shall be refinanced with a series of Senior Lien Bonds which shall be assumed to be amortized over a period not to exceed 25 years and shall be assumed to be amortized in such a manner that the maximum Debt Service Requirements in any twelve month period shall not exceed 110% of the minimum Debt Service Requirements for any other 12-month period, and shall be assumed to bear interest at a fixed interest rate estimated by the City's financial advisor or underwriter to be the interest rate such series of Bonds would bear if issued on such terms on the date of such estimate;

*This provision shall be effective from and after the Amendment Effective Date.

(ii) For any series of Bonds bearing interest at a variable or adjustable rate or a rate to be negotiated or revised from time to time such that the actual future rate of interest thereon cannot be ascertained at the time of calculation, it shall be assumed that such Bonds will bear interest at the higher of (1) a long-term interest rate estimated by the City's financial advisor or underwriter to be the average rate of interest such Bonds would bear if issued as long-term bonds bearing interest at fixed interest rates to be amortized over 30 years with level debt service or (2) a short-term interest rate calculated as follows: (a) for any series of Bonds then Outstanding, at the greater of (i) the average interest rate derived from the variable or adjustable interest rate formula or computation applicable to, or average interest rate borne by, such series of Bonds during a 12-month period ending within 30 days prior to the date of computation or (ii) the actual interest rate derived from such variable or adjustable interest rate formula or computation, or the actual interest rate payable on such series of Bonds, on the date of such calculation, and (b) for any series of Bonds then proposed to be issued, at an interest rate estimated by the City's financial advisor or underwriter to be the average rate of interest such series of Bonds will bear during the period or periods for which the Debt Service Requirements are being calculated.

Debt Service Requirements shall be calculated on the assumption that no Bonds Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of scheduled principal maturities or scheduled mandatory redemptions of such Bonds, except as provided above for Short-Term/Demand Obligations.

Credit Agreements shall cause Debt Service Requirements to be increased only to the extent of scheduled payments and charges for the availability of the Credit Agreement without regard to any repayment or reimbursement obligations or interest thereon or other stipulated costs or charges related thereto.

Qualified Hedge Agreements shall cause Debt Service Requirements to be (i) increased by the amount of any scheduled payments and charges for the availability of the Qualified Hedge Agreement, (ii) decreased by the amount of any scheduled interest payments on the related Bonds which the City's financial advisor certifies to be substantially hedged pursuant to the Qualified Hedge Agreement, and (iii) increased by the gross payments of the City under the Qualified Hedge Agreement (without regard to netting); provided, however, that any variable or adjustable payment obligation of the City under the Qualified Hedge Agreement shall be deemed to be a fixed rate obligation based upon the provisions contained in paragraph (ii) above of the definition of Debt Service Requirements, as certified by the City's financial advisor.

"DTC" means The Depository Trust Company, New York, New York.

"EIS" means environmental impact statement.

"Excluded Fee and Charge Revenues" shall mean all income and revenues (i) derived from fees and charges imposed by City ordinance adopted after July 1, 2007 and declared in such ordinance to constitute fees and charges of the kind that will generate Excluded Fee and Charge Revenues and (ii) relate to periods after the Amendment Effective Date. Such Excluded Fee and Charge Revenues may be authorized pursuant to any federal, state or local authority and may include, but not be limited to, any charge or fee relating to providing, enhancing or maintaining security for the Airport System or any fee or charge imposed on any commercial cargo activity of the Airport System.

"Federal Payments" shall mean those funds received by the Houston Airport System from the federal government or any agency thereof as payments for the use of any facilities or services of the Houston Airport System.

"Fiscal Year" shall mean the City's fiscal year as from time to time designated by the City, which is currently July 1 to June 30.

"Fitch" means Fitch Ratings, a corporation organized and existing under the laws of the State of New York, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, shall be deemed to refer to any other nationally recognized securities rating agency designated by the City, with the consent of the Bond Insurer.

"Gross Revenues" shall mean all income and revenues derived directly or indirectly by the City from the operation and use of and otherwise pertaining to the Houston Airport System, or any part thereof, whether resulting from extensions, enlargements, repairs, betterments or other improvements to the Houston Airport System, or otherwise, and includes, except to the extent hereinafter expressly excluded, all revenues received by the City from the Houston Airport System, including, without limitation, all rentals, rates, fees and other charges for the use of the Houston Airport System, or for any service rendered by the City in the operation thereof, interest and other income realized from the investment or deposit of amounts credited to any fund required to be maintained pursuant to the Ordinance or any other ordinance authorizing the issuance of Bonds. Gross Revenues expressly exclude:

(i) proceeds of any Bonds;

(ii) interest or other investment income derived from Bond proceeds deposited to the credit of any construction fund, or applied to fund capitalized interest, or interest or investment income required to be retained in the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund or any escrow fund in order to accumulate therein any amount or balance required to be accumulated or maintained therein pursuant to any ordinance authorizing any series of Bonds;

(iii) any monies received as grants, appropriations, or gifts, the use of which is limited by the grantor or donor to the construction or acquisition of Houston Airport System facilities, except to the extent any such monies shall be received as payments for the use of the Houston Airport System facilities;

(iv) any revenues derived from any Special Facilities which are pledged to the payment of Special Facilities Bonds;

(v) insurance proceeds other than loss of use or business interruption insurance proceeds;

(vi) the proceeds of any passenger facility charge or other per-passenger charge as may be hereafter authorized under federal law;

(vii) sales and other taxes collected by the Houston Airport System on behalf of the State of Texas and any other taxing entities;

(viii) Federal Payments received by the Houston Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Series 2005A Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes; and

(ix) the net proceeds received by the City from the disposition of any Houston Airport System property.

*(x) Excluded Fee and Charge Revenues after the Amendment Effective Date.

"Houston Airport System" – means a department of the City which operates the Houston Airport System.

"Houston Airport System" shall mean all airport, heliport and aviation facilities, or any interest therein, now or from time to time hereafter owned, operated or controlled in whole or in part by the City, together with all properties, facilities and services thereof, and all additions, extensions, replacements and improvements thereto, and all services provided or to be provided by the City in connection therewith, but expressly excluding Special Facilities. The Houston Airport System currently includes the present airports of the City, known as "George Bush Intercontinental Airport/Houston," "William P. Hobby Airport," and "Ellington Field."

"Houston Airport System Bonds" for purposes of the Official Statement, the term Houston Airport System Bonds shall have the same meaning assigned to the term "Bonds" in the Ordinance, as indicated in this Appendix B.

"Inferior Lien Bonds" shall mean each series of bonds, notes or other obligations permitted to be issued or incurred by the City pursuant to the Ordinance as Senior Lien Bonds secured in whole or in part by liens on the Net Revenues that are junior and subordinate to the lien on Net Revenues securing payment of the Senior Lien Bonds and Subordinate Lien Bonds. Inferior Lien Bonds include but are not limited to the Series C Commercial Paper Obligations and the debt service component of the Houston Airport System's sublease payments in respect of the automated people mover running between Terminals B and C at George Bush Intercontinental Airport/Houston.

"ISEP" means International Services Expansion Program.

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* This Provisions shall be effective from and after the Amendment Effective Date.

"Liquidity Facility" means, initially the Standby Bond Purchase Agreement, and thereafter, any Alternate Liquidity Facility delivered pursuant to the Ordinance and with terms that are not inconsistent with the terms of the Ordinance.

"Moody's" means Moody's Investors Service, Inc., a corporation organized and existing under the laws of the State of Delaware, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the City, with the consent of the Bond Insurer.

"Net Revenues" shall mean that portion of the Gross Revenues remaining after the deduction of the Operation and Maintenance Expenses of the Houston Airport System.

"Officers Pricing Certificate(s)" shall mean the certificate(s) or any other supplemental certificate(s) executed by the Mayor and City Controller with respect to the respective pricings of the Series 2007A Bonds and Series 2007B Bonds pursuant to the Ordinance.

"Operation and Maintenance Expenses" shall mean all reasonable and necessary current expenses of the City, paid or accrued, of operating, maintaining and repairing the Houston Airport System, including, without limitation, those reasonably allocated City overhead expenses relating to the administration, operation and maintenance of the Houston Airport System; insurance and fidelity bond premiums; payments to pension and other funds and to any self-insurance fund not in excess of premiums which would otherwise be required for such insurance; any general and excise taxes or other governmental charges imposed by entities other than the City; costs of contractual and professional services, labor, materials and supplies for current operations, including the costs of such direct City services rendered to the Houston Airport System as are requested from the City by the Houston Airport System and as are reasonably necessary for the operation of the Houston Airport System; costs of issuance of Bonds for the Houston Airport System (except to the extent paid from the proceeds thereof); fiduciary costs; costs of collecting and refunding Gross Revenues; utility costs; any lawful refunds of any Gross Revenues; and all other administrative, general and commercial expenses, but excluding:

(i) any allowance for depreciation;

(ii) costs of capital improvements;

(iii) reserves for major capital improvements, Houston Airport System operations, maintenance or repair;

(iv) any allowance for redemption of, or payment of interest or premium on, Bonds;

(v) any liabilities incurred in acquiring or improving properties of the Houston Airport System;

(vi) expenses of lessees under Special Facilities Leases and operation and maintenance expenses pertaining to Special Facilities to the extent they are required to be paid by such lessees pursuant to the terms of the Special Facilities Leases;

(vii) any charges or obligations incurred in connection with any lawful Houston Airport System purpose, including the lease, acquisition, operation or maintenance of any facility or property benefiting the Houston Airport System, provided that the payment of such charges or obligations is expressly agreed by the payee to be payable solely from proceeds of the Airports Improvement Fund;

(viii) liabilities based upon the City's negligence or other grounds not based on contract; and

(ix) so long as Federal Payments are excluded from Gross Revenues, an amount of expenses that would otherwise constitute Operation and Maintenance Expenses for such period equal to the Federal Payments for such period.

Operation and Maintenance Expenses shall only include those current expenses due or payable within the next 30 days.

"Ordinance" shall mean the Ordinance adopted by the City Council of the City and all amendments and supplements thereto with respect to the Bonds.

"Outstanding" when used with reference to the Senior Lien Bonds or Subordinate Lien Bonds, as the case may be, means, as of a particular date, all such bonds theretofore and thereupon delivered except: (a) any such bond cancelled by or on behalf of the City at or before said date; (b) any such bond defeased pursuant to the defeasance provisions of the ordinance authorizing its issuance, or otherwise defeased as permitted by applicable law; and (c) any such bond in lieu of or in substitution for which another bond shall have been delivered pursuant to the ordinance authorizing the issuance of such bond.

"Owner" or **"Registered Owner"**, when used with respect to any Senior Lien Bond or Subordinate Lien Bond shall mean the person or entity in whose name such bond is registered in the Register. Any reference to a particular percentage or proportion of the Owners shall mean the Owners at a particular time of the specified percentage or proportion in aggregate principal amount of all Senior Lien Bonds or Subordinate Lien Bonds then Outstanding under the Ordinance.

"Participant" means, with respect to DTC or another Securities Depository, a member of or participant in DTC or such other Securities Depository, respectively.

"Paying Agent/Registrar" shall mean, for the Series 2007 Bonds, initially Wells Fargo Bank, N.A., and its successors in that capacity.

"PFC Revenues" shall mean, during any Fiscal Year, proceeds of any charges and fees collected by the Houston Airport System, including passenger facility charges collected by the City pursuant to the authority granted by the Aviation Safety and Capacity Expansion Act of 1990 and 14 CFR Part 158, as amended from time to time, in respect to any component of the Airport System, and interest earnings thereon.

"Qualified Hedge Agreement" shall mean any agreement between the City and a qualifying financial institution (as described in the following sentence) for the purpose of providing an interest rate swap, exchange, cap, collar, floor, forward or other hedging mechanism, arrangement or security, however denominated, expressly identified pursuant to its terms as being entered into in connection with and in order to hedge interest rate fluctuations on any portion of any Bonds and in consideration for which the City may agree to pay, but solely from Net Revenues as herein provided, (i) periodic payments for the availability of such Qualified Hedge Agreement and/or (ii) net amounts as a result of fluctuation in hedged interest rates or in the value of any index of payment and/or (iii) termination charges. A Qualified Hedge Agreement may only be entered into with a financial institution which has long term credit ratings or the obligations of which are unconditionally guaranteed by a financial institution with long term credit ratings in one of the two highest generic rating categories by each nationally recognized rating service then rating the Bonds. Obligations of the City pursuant to a Qualified Hedge Agreement shall be included within the definition of Debt Service Requirements for the series of Bonds to which the Qualified Hedge Agreement relates. Further, obligations of the City to make payments under a Qualified Hedge Agreement derived from or resulting from a fluctuation in hedged interest rates or in the value of any index of payment shall be deemed to be payments of interest on the Bonds so hedged. Each Qualified Hedge Agreement shall be deemed to be a part of the Bonds of the series to which it relates for the purpose of securing its payment by the pledge of Net Revenues as provided in Articles V, VI, and VII of the Ordinance. However, issuers of and counterparties to Qualified Hedge Agreements shall not be treated as Owners of Bonds for purposes of any voting rights to approve amendments or direct the exercise of any remedies under the Ordinance.

"Refunded Bond Escrow Agent" shall mean The Bank of New York Trust Company, N.A., successor to JPMorgan Chase Bank, National Association (formerly The Chase Manhattan Bank), and its successors in such capacity.

"Refunded Bond Escrow Agreement" shall mean the agreement between the City and the Refunded Bond Escrow Agent related to Refunded Bonds, in substantially the form set forth in Exhibit G-1.

"Refunded Bond Escrow Fund" shall mean the escrow fund created under the Refunded Bond Escrow Agreement and maintained by the Refunded Bond Escrow Agent.

"Refunded Bonds" shall mean certain Houston Airport System bonds as further described in Appendix A.

"Refunded Note Escrow Agent" shall mean the U.S. Bank, National Association and its successors in such capacity.

"Refunded Note Escrow Agreement" shall mean the agreement by and between the City and the Refunded Note Escrow Agent related to the Refunded Notes, in substantially the form set forth in Exhibit G-2.

"Refunded Note Escrow Fund" shall mean the escrow fund or funds created under the Refunded Note Escrow Agreement and maintained by the Refunded Note Escrow Agent.

"Refunded Notes" shall mean all or a portion of the Series A Commercial Paper Notes and Series B Commercial Paper Notes outstanding as of the date of each respective pricing as further described in Exhibit A.

"Register" shall mean the books of registration kept by the Paying Agent/Registrar in which are maintained the name and address of, and the principal amounts registered to, each Owner.

"Renewal and Replacement Fund Requirement" shall mean the amount required to be maintained in the Renewal and Replacement Fund pursuant to the Ordinance, or any greater amount required by any ordinance authorizing any series of Additional Senior Lien Bonds or Additional Subordinate Lien Bonds.

"Reserve Fund Requirement" shall mean the amount required to be maintained in the Senior Lien Bond Reserve Fund or the Subordinate Lien Bond Reserve Fund, as the case may be. For Senior Lien Bonds, such amount shall be the amount required in the ordinances authorizing the Senior Lien Bonds. For Subordinate Lien Bonds, such amount shall be computed and recomputed upon the issuance of each series of Subordinate Lien Bonds and on each date on which Subordinate Lien Bonds are paid at maturity or optionally or mandatorily redeemed, to be the greatest amount of the Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for all Subordinate Lien Bonds then Outstanding, including any series of Subordinate Lien Bonds then being issued. Upon the issuance of the Series 2005A Bonds, the Reserve Fund Requirement for the Subordinate Lien Bonds shall be as set forth in the Officers Pricing Certificate.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successors and assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the City, with the consent of the Bond Insurer.

"Securities Act" means the Securities Act of 1933, as amended, and any successor thereto.

"Senior Lien Bond Interest and Sinking Fund" shall mean the fund so designated which was created and established pursuant to the ordinances authorizing the Senior Lien Bonds and which is maintained pursuant to the Ordinance.

"Senior Lien Bond Reserve Fund" shall mean the fund so designated which was created and established pursuant to the ordinances authorizing the Senior Lien Bonds and which is maintained pursuant to the Ordinance.

"Senior Lien Bonds" shall mean the Outstanding Series A and B Commercial Paper Obligations and each series of Additional Senior Lien Bonds from time to time hereafter issued.

"Series 1997 Bonds" shall mean the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 1997 (NON-AMT).

"Series 1998 Bonds" shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Forward Refunding Bonds, Series 1998A, the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds, Series 1998B (AMT), and the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds, Series 1998C (Non-AMT).

"Series 2000 Bonds" shall collectively mean the City of Houston, Texas Airport System Subordinate Lien Revenue Bonds Series 2000A (AMT), Series 2000B (Non-AMT) and the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds (Periodic Auction Reset Securities), Series 2000P-1 (AMT) and P-2 (AMT).

"Series 2001 Bonds" shall mean the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2001A (AMT).

"Series 2002 Bonds" shall collectively mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds Series 2002A (AMT), the Series 2002B (Non-AMT), the Series 2002C (AMT) (Auction Rate Securities), the Series 2002D-1 (AMT) (Auction Rate Securities), and the Series 2002D-2 (AMT) (Auction Rate Securities).

"Series 2005A Bonds" shall mean the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2005A (AMT).

"Series 2007 Bonds" shall mean collectively the Series 2007A (AMT) Bonds and the Series 2007B (NON-AMT) Bonds, all as authorized by the Ordinance and one or more Officers Pricing Certificate.

"Series 2007 Subordinate Lien Reserve Fund Surety Policy" shall mean the debt service reserve fund policy or policies issued in the amount(s) and by the provider identified in the Officers Pricing Certificate.

"Series 2007A Bonds" shall mean the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007A (AMT), all as authorized by the Ordinance and one or more Officers Pricing Certificate.

"Series 2007B Bonds" shall mean the City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007 (NON-AMT), all as authorized by the Ordinance and one or more Officers Pricing Certificate.

"Series A and B Commercial Paper Obligations" shall mean the Series A Commercial Paper Notes and the Series B Commercial Paper Notes and credit agreements related thereto.

"Series A Commercial Paper Notes" shall mean the City of Houston, Texas Airport System Senior Lien Commercial Paper Notes, Series A (AMT).

"Series B Commercial Paper Notes" shall mean the City of Houston, Texas Airport System Senior Lien Commercial Paper Notes, Series B (NON-AMT).

"Series C Commercial Paper Obligations" shall mean the City of Houston, Texas Airport System Inferior Lien Commercial Paper Notes, Series C and any credit agreements related thereto.

"Short Term/Demand Obligations" shall mean each series of bonds, notes and other obligations issued in accordance with the Ordinance, (a) the payment of principal of which is either (i) payable on demand by or at the option of the holder at a time sooner than a date on which such principal is deemed to be payable for purposes of computing Debt Service Requirements, or (ii) scheduled to be payable within one year from the date of issuance and is contemplated to be refinanced for a specified period or term through the issuance of additional Short Term/Demand Obligations pursuant to a commercial paper or other similar financing program, and (b) the purchase price, payment or refinancing of which is additionally secured by a letter of credit, line of credit, standby bond purchase agreement, bond insurance, surety bond or other credit or liquidity facility which does not impose upon the City a reimbursement obligation payable over a period shorter than three years.

"Special Facilities" shall mean structures, hangars, aircraft overhaul, maintenance or repair shops, heliports, hotels, storage facilities, garages, in-flight kitchens, training facilities, consolidated rental car facilities, terminal facilities, cargo facilities and any and all other facilities and appurtenances being a part of or related to the Houston Airport System, the cost of the construction or other acquisition of which is financed with the proceeds of Special Facilities Bonds.

"Special Facilities Bonds" shall mean any bonds heretofore or from time to time hereafter issued by the City to finance and refinance the cost of any Special Facilities pursuant to the Ordinance.

"Special Facilities Lease" shall mean any lease or agreement, howsoever denominated, pursuant to which a Special Facility is leased by the City to the lessee in consideration for which the lessee agrees to pay (i) all debt service on the Special Facilities Bonds issued to finance the Special Facilities (which payments are pledged to secure the Special Facilities Bonds) and (ii) the operation and maintenance expenses of the Special Facilities.

"Subordinate Lien Bond Interest and Sinking Fund" shall mean the fund so designated which is required to be maintained pursuant to the Ordinance.

"Subordinate Lien Bond Reserve Fund Surety Policy" shall mean any one or more of the instruments so defined in the Ordinance, whether heretofore or hereafter acquired for the purpose of satisfying all or any part of the Reserve Fund Requirement for the Subordinate Lien Bonds.

"Subordinate Lien Bond Reserve Fund" shall mean the fund so designated which is required to be maintained pursuant to the Ordinance.

"Subordinate Lien Bonds" shall mean the Outstanding Series 1997 Bonds, Series 1998 Bonds, Series 2000 Bonds, Series 2001 Bonds, Series 2002 Bonds, Series 2005A Bonds, and the Series 2007 Bonds, and each series of Additional Subordinate Lien Bonds which the City has reserved the right to issue from time to time, payable from and secured by a lien on and pledge of Net Revenues junior and subordinate to the lien and pledge securing the Senior Lien Bonds.

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APPENDIX I

ADDITIONAL INFORMATION REGARDING BOND RESERVE FUND SURETY POLICIES

The following information has been obtained from Financial Guaranty Insurance Company, XL Capital Assurance Inc., and Financial Security Assurance Inc. The City, the Co-Financial Advisors to the City and the Underwriter do not make any representations as to the completeness or accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

Financial Guaranty Insurance Company Policies

Prior to the issuance of the Bonds, Financial Guaranty Insurance Company ("Financial Guaranty") issued several Municipal Bond Debt Service Reserve Fund Policies (the "Reserve Policies"). The Reserve Policies unconditionally guarantee the payment of a portion of the principal or accreted value (if applicable) of and interest on the Outstanding Subordinate Lien Bonds which have become due for payment, but shall be unpaid by reason of nonpayment by the City, provided that the aggregate amount paid under the Reserve Policy may not exceed the maximum amount set forth in the Reserve Policies, which amount is currently $105,291,488.70 (and will be $108,444,368.70 after issuance of the Series 2007B Bonds). Financial Guaranty will make such payments to the Paying Agent for the Outstanding Subordinate Lien Bonds on the later of the date on which such principal or accreted value (if applicable) and interest is due or on the business day next following the day on which Financial Guaranty shall have received telephonic or telegraphic notice subsequently confirmed in writing or written notice by registered or certified mail from the Paying Agent of the nonpayment of such amount by the City. The term "nonpayment" in respect of an Outstanding Subordinate Lien Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of an Outstanding Subordinate Lien Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final nonappealable order of a court having competent jurisdiction.

The Reserve Policies are non-cancellable. The Reserve Policies covers failure to pay principal or accreted value (if applicable) of the Subordinate Lien Bonds on their respective stated maturity dates, or dates on which the same shall have been called for mandatory sinking fund redemption, and not on any other date on which the Subordinate Lien Bonds may have been accelerated, and covers the failure to pay an installment of interest on the stated date for its payment. The Reserve Policies shall terminate on the dates set forth in such Reserve Fund Policies. A $24,477,885 policy terminates on July 1, 2022, a $5,494,503.70 policy expires on July 1, 2017, a $32,050,000 policy terminates on July 1, 2028, a $43,269,100 policy terminates on July 1, 2030, and a $3,152,880 policy (to be issued at the closing of the Series 2007B Bonds) terminates on July 1, 2032. The City presently has three outstanding Senior Lien Bond Reserve Fund Surety Policies issued by Financial Guaranty in an aggregate maximum amount of $12,374,996. The Senior Lien Bond Reserve Fund Surety Policies terminate on various dates beginning October 25, 2023.

Generally, in connection with its issuance of Reserve Policies, Financial Guaranty, among other things, (i) that, so long as it has not failed to comply with its payment obligations under the Reserve Policy, it be granted the power to exercise any remedies available at law or under the authorizing document other than (A) acceleration of any Outstanding Subordinate Lien Bonds or (B) remedies which would adversely affect holders in the event that the issuer fails to reimburse Financial Guaranty for any draws on the Reserve Policies; and (ii) that any amendment or supplement to or other modification of the principal legal documents be subject to Financial Guaranty's consent. The specific rights, if any, granted to Financial Guaranty in connection with its issuance of the Reserve Policy may be set forth in the description of the principal legal documents appearing elsewhere in this Official Statement. Reference should be made as well to such description for a discussion of the circumstances, if any, under which the City of the Outstanding Subordinate Lien Bonds is required to provide additional or substitute credit enhancement, and related matters.

The Reserve Policies are not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

In the event that Financial Guaranty is unable to fulfill its obligations under the Reserve Policy, the policy holder or bondholder is not protected by an insurance guaranty fund or other solvency protection arrangement.

For additional information about Financial Guaranty and its credit rating, see "BOND INSURANCE."

XL Capital Assurance Inc. Policies

Prior to the issuance of the Bonds, XL Capital Assurance Inc. ("XLCA") issued several Municipal Bond Debt Service Reserve Fund Policies (the "XL Reserve Policies"). The XL Reserve Policies unconditionally guarantee the payment of that portion of the principal or accreted value (if applicable) of and interest on the Outstanding Subordinate Lien Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the City, provided that the aggregate amount paid under the Reserve Policies may not exceed the maximum amount set forth in the Reserve Policies, $15,756,228.00. XLCA will make such payments to the Paying Agent for the Outstanding Subordinate Lien Bonds on the later of the date on which such principal or accreted value (if applicable) and interest is due or on the business day next following the day on which XLCA shall have received telephonic or telegraphic notice subsequently confirmed in writing or written notice by registered or certified mail from the Paying Agent of the nonpayment of such amount by the City. The term "nonpayment" in respect of a Outstanding Subordinate Lien Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a Outstanding Subordinate Lien Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final nonappealable order of a court having competent jurisdiction.

The XL Reserve Policies are non-cancelable. The XL Reserve Policies cover failure to pay principal or accreted value (if applicable) of the Outstanding Subordinate Lien Bonds on their respective stated maturity dates, or dates on which the same shall have been called for mandatory sinking fund redemption, and not on any other date on which the Outstanding Subordinate Lien Bonds may have been accelerated, and covers the failure to pay an installment of interest on the stated date for its payment. The XL Reserve Policies shall terminate on the earlier of (i) July 1, 2032 and (ii) the date the City's Airport System Subordinate Lien Revenue Bonds, Series 2002C, Series 2002D-1 and Series 2002D-2 are no longer outstanding.

General

XLCA is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. XLCA is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and Singapore.

XLCA is an indirect wholly owned subsidiary of Security Capital Assurance Ltd ("SCA"), a company organized under the laws of Bermuda. Through its subsidiaries, SCA provides credit enhancement and protection products to the public finance and structured finance markets throughout the United States and internationally. XL Capital Ltd beneficially owns approximately 63% of SCA's outstanding shares. The common shares of SCA are publicly traded in the United States and listed on the New York Stock Exchange (NYSE: SCA). SCA is not obligated to pay the debts of or claims against XLCA.

Financial Strength and Financial Enhancement Ratings of XLCA

XLCA's insurance financial strength is rated "Aaa" by Moody's and "AAA" by Standard & Poor's and Fitch, Inc. ("Fitch"). In addition, XLCA has obtained a financial enhancement rating of "AAA" from Standard & Poor's. These ratings reflect Moody's, Standard & Poor's, and Fitch's current assessment of XLCA's creditworthiness and claims-paying ability as well as the reinsurance arrangement with XL Financial Assurance Ltd. ("XLFA") described under "Reinsurance" below.

The above ratings are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody's, Standard & Poor's, or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the Bonds. XLCA does not guaranty the market price of the Bonds nor does it guaranty that the ratings on the Bonds will not be revised or withdrawn.

Reinsurance

XLCA has entered into a facultative quota share reinsurance agreement with XLFA, an insurance company organized under the laws of Bermuda, and an affiliate of XLCA. Pursuant to this reinsurance agreement, XLCA expects to cede up to 75% of its business to XLFA. XLCA may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by XLCA as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit XLCA's obligations under any financial guaranty insurance policy. With respect to any transaction insured by XLCA, the percentage of risk ceded to XLFA may be less than 75% depending on certain factors including, without limitation, whether XLCA has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XLCA, including the Policy.

Based on the audited financials of XLFA, as of December 31, 2005, XLFA had total assets, liabilities, redeemable preferred shares and shareholders' equity of $1,394,081,000, $704,007,000, $39,000,000, and $651,074,000, respectively, determined in accordance with generally accepted accounting principles in the United States ("US GAAP"). XLFA's insurance financial strength is rated "Aaa" by Moody's and "AAA" by S&P and Fitch Inc. In addition, XLFA has obtained a financial enhancement rating of "AAA" from S&P.

The ratings of XLFA or any other member of the SCA group of companies are not recommendations to buy, sell or hold securities, including the Bonds and are subject to revision or withdrawal at any time by Moody's, Standard & Poor's, or Fitch.

Notwithstanding the capital support provided to XLCA described in this section, the Bondholders will have direct recourse against XLCA only, and XLFA will not be directly liable to the Bondholders.

Capitalization of XLCA

Based on the audited financials of XLCA, as of December 31, 2005, XLCA had total assets, liabilities, and shareholder's equity of $953,706,000, $726,758,000, and $226,948,000, respectively, determined in accordance with U.S. GAAP.

Based on the audited statutory financial statements for XLCA as of December 31, 2005 filed with the State of New York Insurance Department, XLCA has total admitted assets of $328,231,000, total liabilities of $139,392,000, total capital and surplus of $188,839,000 and total contingency reserves of $13,031,000 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities ("SAP").

Incorporation by Reference of Financials

For further information concerning XLCA and XLFA, see the financial statements of XLCA and XLFA, and the notes thereto, incorporated by reference in this Official Statement. The financial statements of XLCA and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the " Commission") by SCA, with respect to all periods ending after August 4, 2006, and by XL Capital Ltd, with respect to all periods ending prior to August 4, 2006, and may be reviewed at the EDGAR website maintained by the Commission. All financial statements of XLCA and XLFA included in, or as exhibits to, documents filed by SCA or XL Capital Ltd pursuant to Section 13(a), 13(c), 14, or 15(d) of the Securities Exchange Act of 1934 on or prior to the date of this Official Statement, or after the date of this Official Statement but prior to termination of the offering of the Bonds, shall be deemed incorporated by reference in this Official Statement. Except for the financial statements of XLCA and XLFA, no other information contained in the reports filed with the Commission by SCA or XL Capital Ltd is incorporated by reference. Copies of the statutory quarterly and annual statements filed with the State of New York Insurance Department by XLCA are available upon request to the State of New York Insurance Department.

Regulation of XLCA

XLCA is regulated by the Superintendent of Insurance of the State of New York. In addition, XLCA is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State of New York, XLCA is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. XLCA is also required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but New York and most other jurisdictions have laws and regulations prescribing permitted investments and governing the payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

THE FGIC INSURANCE POLICIES ISSUED BY XLCA ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

The principal executive offices of XLCA are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478-3400.

Financial Security Assurance Inc. Policies

Prior to the issuance of the Bonds, Financial Security Assurance Inc. ("FSA") issued Municipal Bond Debt Service Reserve Fund Policies in connection with the $200,050,000 Series 2002A (AMT) and $274,455,000 Series 2002B (Non-AMT) Bonds (the "FSA Reserve Policies"). The FSA Reserve Policies unconditionally guarantee the payment of that portion of the principal or accreted value (if applicable) of and interest on the Outstanding Subordinate Lien Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the City, provided that the aggregate amount paid under the FSA Reserve Policies may not exceed the maximum amount set forth in the FSA Reserve Policies, $31,921,383.50. FSA will make such payments to the Paying Agent for the Outstanding Subordinate Lien Bonds on the later of the date on which such principal or accreted value (if applicable) and interest is due or on the business day next following the day on which FSA shall have received telephonic or telegraphic notice subsequently confirmed in writing or written notice by registered or certified mail from the Paying Agent of the nonpayment of such amount by the City. The term "nonpayment" in respect of a Outstanding Subordinate Lien Bond includes any payment of principal, accreted value or interest (as applicable) made to an owner of a Outstanding Subordinate Lien Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final nonappealable order of a court having competent jurisdiction.

The FSA Reserve Policies are non-cancelable. The FSA Reserve Policies cover failure to pay principal or accreted value (if applicable) of the Outstanding Subordinate Lien Bonds on their respective stated maturity dates, or dates on which the same shall have been called for mandatory sinking fund redemption, and not on any other date on which the Outstanding Subordinate Lien Bonds may have been accelerated, and covers the failure to pay an installment of interest on the stated date for its payment. The FSA Reserve Policies shall terminate on the earlier of (i) July 1, 2032 and (ii) the date the City's Airport System Subordinate Lien Revenue Bonds, Series 2002C, Series 2002D-1 and Series 2002D-2 are no longer outstanding.

General

The FSA Reserve Policies do not protect investors against changes in market value of the Outstanding Subordinate Lien Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the Outstanding Subordinate Lien Bonds or the advisability of investing in the Outstanding Subordinate Lien Bonds. FSA makes no representation regarding this Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the City the information presented under this caption for inclusion in this Official Statement.

FSA is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings"). Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At September 30, 2006, FSA's combined policyholders' surplus and contingency reserves were approximately $2,581,107,000 and its total net unearned premium reserve was approximately $1,992,163,000 in accordance with statutory accounting principles. At September 30, 2006, FSA's consolidated shareholder's equity was approximately $3,058,987,000 and its total net unearned premium reserve was approximately $1,590,538,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of FSA included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the Securities and Exchange Commission are hereby incorporated by reference into this Official Statement. All financial statements of FSA included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14, or 15(d) of the Securities Exchange Act of 1934 after the date of this Official Statement and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the Bonds or the advisability of investing in the Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided to the City the information presented under this caption for inclusion in the Official Statement.

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CITY OF HOUSTON, TEXAS • AIRPORT SYSTEM SUBORDINATE LIEN REVENUE REFUNDING BONDS SERIES 2007B (NON-AMT)

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