Houston First Corporation

(A Component Unit of the City of Houston, Texas)

Financial Statements as of and for the Years Ended December 31, 2016 and 2015, and Independent Auditors' Report

HOUSTON FIRST CORPORATION
(A Component Unit of the City of Houston, Texas)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Houston First Corporation
Houston, Texas

We have audited the accompanying consolidated financial statements of Houston First Corporation and its subsidiary (the "Corporation"), which comprise the statements of net position as of December 31, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the net position of Houston First Corporation and its subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-11 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte & Touche LLP

July 20, 2017

The following discussion of Houston First Corporation (the "Corporation") should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. Historical results and trends that might appear should not be taken as indicative of future operations. The results of operations and financial condition of the Corporation, as reflected in the accompanying financial statements and related notes, are subject to management's evaluation and interpretation of business conditions, changing capital market conditions, and other factors that could affect the ongoing viability of the Corporation.

The Houston Convention Center Hotel Corporation ("Hotel Corporation") was formed on behalf of the City of Houston, Texas (the "City"), in February 2000 pursuant to Chapter 431, Subchapter D, of the Texas Transportation Code, and Chapter 394 of the Texas Local Government Code. It was organized for the specific purpose of constructing, improving, enlarging, equipping, repairing, operating, and maintaining a convention center hotel (the "Hotel") located near and connected to the George R. Brown Convention Center (the "Convention Center"). In this regard, the Hotel Corporation was responsible for overseeing the construction and development of the Hotel; a 1,600-space parking garage (the "Parking Garage"); and three skywalks connecting the Hotel, the Parking Garage, and the Convention Center (the "Project"). Construction was completed and the Project opened for business in December 2003 as the Hilton Americas–Houston (the "Hilton"). As of December 31, 2016 and 2015, Hilton Management LLC managed the Hotel through a qualified management contract (the "Management Agreement").

On June 1, 2011, the Houston City Council (the "City Council") approved the consolidation of the City's Convention & Entertainment Facilities Department (the "Department") into the Hotel Corporation (the "Consolidation"), effective July 1, 2011, in order to improve the coordination of the City's convention and entertainment services by bringing various entities responsible for generating and spending City hotel occupancy tax ("HOT") revenues under one governing body. In connection with the Consolidation, the Hotel Corporation reconstituted and renamed itself as the "Houston First Corporation," which assumed the primary roles and responsibilities of the Department. To accomplish this, the Hotel Corporation amended its bylaws and articles of incorporation to broaden its authority to accomplish its expanded duties and responsibilities. The Corporation has the authority to exercise all rights and privileges of a Texas nonprofit corporation and, as a governmental unit within the meaning of Chapter 101 of the Texas Civil Practice Remedies Code, its operations are governmental and not proprietary functions. The Corporation is governed by the board of directors appointed and approved by the Mayor and the City Council.

The Corporation (a) leases all previously existing Department facilities and Department-managed facilities; (b) operates, manages, maintains, develops, and redevelops those existing facilities; (c) has been assigned and now administers all of the Department's obligations and responsibilities, as well as its revenue budgeted as part of the Department's budget, including, but not limited to, municipal HOT receipts, license fees, and concession revenues; and (d) as the City's agent, collects, administers, and audits HOT funds in accordance with terms of City ordinances. The City has entered into an interlocal agreement (the "Consolidation Interlocal Agreement") with the Corporation, whereby the Corporation will lease all existing Department facilities and Department-managed facilities. The Corporation also agreed to pay the City a one-time fee of $8,620,000 during the City's fiscal year ended June 30, 2012, from operating revenues of the Hotel. The Consolidation Interlocal Agreement's initial term expires on December 31, 2026, but will be extended automatically until June 30, 2041, unless canceled by either party on or before June 30, 2026.

On March 4, 2013, the Corporation formed Houston First Holdings, LLC, a wholly owned subsidiary of the Corporation, as a "special-purpose" entity for the purpose of owning, holding, selling, leasing, transferring, exchanging, operating, managing, and otherwise dealing with the Hilton and its parking garage.

On June 18, 2014, the Corporation entered into a Services Agreement with the Greater Houston Convention and Visitors Bureau ("the Bureau") which engaged the Corporation to provide advertising and promotional programs on behalf of the Bureau at a minimum of the same levels as previously funded by the Corporation to the Bureau. The Bureau's employees have been added to the Corporation's existing personnel contract effective July 1, 2014. The Services Agreement required the Corporation to amend its Certificate of Formation to increase the number of authorized board members from 11 to 13 to include 2 Bureau board members.

For the years ended December 31, 2016 and 2015, the combination of interest earned from investments and net revenues from the operations of the Hilton were sufficient to fund expenses of the Hilton, pay the monthly debt service expense of the Hilton, and fund the remaining obligations between the Hilton and the City.

OVERVIEW OF THE FINANCIAL STATEMENTS

The statements of net position present information on all of the Corporation's assets, deferred outflows and inflows of resources and liabilities, with the difference reported as net position. Comparisons in net position may serve as a useful indicator of whether the financial position of the Corporation is improving or deteriorating. The statements of net position can be found on page 12 of this report.

The statements of revenues, expenses, and changes in net position report the Corporation's revenues, expenses, and resulting change in net position during the period reported, regardless of when cash is received or paid. Therefore, revenues and expenses are reported in the statements of revenues, expenses, and changes in net position for some items that will affect cash flow in future fiscal years. The statements of revenues, expenses, and changes in net position can be found on page 13 of this report.

The statements of cash flows report how much cash was provided by, or used for, the Corporation's operations, investing activities, and acquisition or retirement of capital assets. The statements of cash flows can be found on pages 14-15 of this report.

The notes to the financial statements provide additional information that is essential for a complete understanding of the data in the financial statements described above. The notes to the financial statements can be found on pages 16–30 of this report.

NET POSITION

Total net position at December 31, 2016, was $152,215,691, a 2.05% decrease from December 31, 2015. Total net position at December 31, 2015, was $155,408,778, a 14.7% increase from December 31, 2014. Total net position at December 31, 2014 was $135,442,004.

The Corporation’s net position decreased $3,193,087 to $152,215,691 at December 31, 2016 from $155,408,778 at December 31, 2015. Of this decrease, $17,263,459 is attributable to an increase in assets offset primarily by a decrease in liabilities of $13,588,185 as described below.

The Corporation’s net position increased $19,966,774 at December 31, 2015, to $155,408,778 from $135,442,004 at December 31, 2014. Of this increase, $55,578,104 is attributable to a decrease in assets offset primarily by a decrease in liabilities of $39,286,014 as described below.

CONDENSED STATEMENTS OF NET POSITION

DECEMBER 31, 2016, 2015 AND 2014

	December 31, 2016	December 31, 2015	December 31, 2014
Current assets	$ 119,893,248	$ 212,047,024	$ 261,280,270
Noncurrent assets	90,699,410	86,235,444	69,948,207
Capital assets	397,794,838	327,368,487	238,844,374
Total assets	$ 608,387,496	$ 625,650,955	$ 570,072,851
Deferred outflow of resources	$ 4,550,440	$ 4,068,253	$ 393,569
Current liabilities	$ 58,152,920	$ 59,404,669	$ 43,898,337
Long-term liabilities	402,569,325	414,905,761	391,126,079
Total liabilities	$ 460,722,245	$ 474,310,430	$ 435,024,416
Net position	$ 152,215,691	$ 155,408,778	$ 135,442,004

Total assets decreased $17,263,459 to $608,387,496 at December 31, 2016 from $625,650,955 at December 31, 2015. This decrease is primarily the result of an operating loss of $3,193,087, debt service payment of $9,160,000 and reductions of other liabilities.

Total assets increased $55,578,104 to $625,650,955 at December 31, 2015, from $570,072,851 at December 31, 2014. This increase is primarily the result of operating income of $19,966,744 and proceeds from the City’s 2015 refunding of $34,000,000 described below.

Total liabilities decreased $13,588,185 to $460,722,245 in 2016 from $474,310,430 in 2015, which was primarily attributable to principal payments to the City of Houston for the HFC allocated bonds and premium amortization, and decrease in current liabilities. See the “Debt Issuance” section below for the details of each of the bonds that comprise the note payable to the City.

Total liabilities increased $39,286,014 in 2015 to $474,310,430 from $435,024,416 in 2014, which was primarily attributable to borrowing $34,000,000 from the City as part of the 2015 refunding.

Debt Issuance

In August 2014, the City issued $73,725,000 of Hotel Occupancy Tax and Special Revenue Refunding Bonds. This issue included $52,195,000 of serial bonds, with stated interest rates between 2% and 5% maturing in various amounts from 2015 to 2032, and $21,530,000 of Term Bonds with stated interest rates of 5% maturing in various amounts from 2033 to 2039. The true interest cost was 4%. Proceeds were used to (a) refund the Corporation-allocated Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2012 entirely; (b) finance certain Convention District Project costs; and (c) pay the costs of issuance of the Bonds. Net present value savings totaled $4.6 million or 11% of the refunded bonds. New money proceeds from the refunding totaled $39,200,000.

On March 19, 2015, the City issued $132,590,000 of Hotel Occupancy Tax and Special Revenue Refunding Bonds. This issue included $99,620,000 Serial Bonds with stated interest rates between 2% and 5%, maturing in various amounts from 2015 to 2035, and $32,970,000 of Term Bonds with stated interest rates between 4% and 5% maturing in various amounts from 2035 to 2044. The true interest cost was 3.3%. Proceeds were used to (a) refund a portion of the City's Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2011A and 2011B, (b) refund outstanding commercial paper, (c) finance certain project costs, and (d) pay the costs of issuance of the Bonds. Net present value savings totaled $9.2 million or 13.1% of the refunded bonds. New money proceeds from the refunding totaled $34,000,000.

The Corporation made principal payments totaling $9,160,000 and $8,820,000 in 2016 and 2015, respectively. The total notes payable balance includes the Corporation's allocable portion of the unamortized bond premiums, net of discounts, which totaled $19,161,811 and $20,769,403 at December 31, 2016 and 2015, respectively. The Corporation funds 1/12th of the annual principal payment each month so that, on September 1 of each year, the full principal amount will be available for payment. These funds are held by the City.

Funds held by the City, listed as equity in pooled investments—restricted, include the debt service reserve funds and the debt service funds, and are invested in the City's general investment pool. The amount of the investments held by the City was $19,843,207 and $19,619,945 at December 31, 2016 and 2015, respectively.

CONDENSED STATEMENTS OF CHANGES IN NET POSITION

DECEMBER 31, 2016, 2015, AND 2014

	December 31, 2016	December 31, 2015	December 31, 2014
OPERATING REVENUES:			
Hotel revenues	$ 91,282,156	$ 99,806,481	$ 92,728,856
Venue revenues	17,322,227	16,794,009	18,495,043
Parking revenues	8,280,885	7,732,451	6,211,089
Other operating revenues	3,107,604	3,357,103	5,348,294
Total operating revenues	119,992,872	127,690,044	122,783,282
OPERATING EXPENSES:			
Hotel expenses	39,011,230	38,575,885	33,803,985
Venue expenses	30,436,248	30,844,032	29,207,432
Parking expenses	9,573,253	9,409,365	7,202,814
Visit Houston expenses	24,482,295	18,285,946	6,792,101
General and administrative	42,356,188	38,334,538	33,173,559
Enterprise Development	4,009,565	3,592,056	581,911
Depreciation and amortization	11,585,818	10,377,444	9,740,175
Total operating expenses	161,454,597	149,419,266	120,501,977
OPERATING INCOME (LOSS)	(41,461,725)	(21,729,222)	2,281,305
NONOPERATING REVENUES (EXPENSES):			
Tax rebates	-	-	521,330
Transfers from primary government	72,152,657	74,135,879	79,695,847
GHCVB contract expense	-	-	(9,351,707)
Sponsorship expense	(7,834,968)	(4,089,095)	(4,418,156)
Transfers to primary government	(18,064,748)	(18,645,234)	(18,831,423)
Transfers to affiliate	-	-	(1,471,650)
Interest expense	(8,512,175)	(9,986,314)	(11,708,479)
Interest income	527,872	280,760	850,967
Total nonoperating revenues	38,268,638	41,695,996	35,286,729
CHANGE IN NET POSITION	(3,193,087)	19,966,774	37,568,034
NET POSITION—Beginning of year	155,408,778	135,442,004	97,873,970
NET POSITION—End of year	$ 152,215,691	$ 155,408,778	$ 135,442,004

1. Operating Revenues

Total operating revenues for 2016 and 2015 were $119,992,872 and $127,690,044, respectively, which represents a 6.03% decrease of $7,697,172. The majority of the decrease in operating revenues for 2016 was attributable to a decrease in room revenue and food and beverage revenue at the hotel caused by weakness in the local economy.

Total operating revenues for 2015 and 2014 were $127,690,044 and $122,783,282, respectively, which represents a 4% increase of $4,906,762. The majority of the increase was attributable to an increase in room revenue and food and beverage revenue at the hotel as well as an increase in parking revenue. This was offset by a decrease in food and beverage revenue at the convention center venue, and a decrease in other operating revenue.

2. Tax Rebates

Tax rebates remained at zero in 2016 after decreasing to zero in 2015 from $521,330 in 2014. The decrease was due to the expiration of these rebates in December of 2013.

3. Transfers from Primary Government

In the Consolidation Interlocal Agreement, the City assigned to the Corporation the net available pledged revenues to pay for operating expenses, capital expenditures, and for any other lawful purpose. The transfers represent the HOT and pledged parking revenues remaining after debt service and other debt-related expenses, the remaining initial working capital transfer, and the transfer of other remaining Department fund balances. For 2016, the amount transferred from the Department was $72,152,657, a decrease of $1,983,222 from 2015. For 2015, the amount transferred from the Department was $74,135,879, a decrease of $5,559,968 from 2014. For 2014, the amount transferred from the department was $79,695,847. The decrease for all years is in direct correlation with HOT revenues and parking revenues at the City.

4. Operating Expenses

Total operating expenses increased $12,035,331 to $161,454,597 in 2016 from $149,419,266 in 2015. The increase is primarily due to an increase in Visit Houston expenses, general and administrative expenses, and depreciation and amortization expense.

Visit Houston expenses increased $6,196,349 to $24,482,295 in 2016 from $18,285,946 in 2015. The Corporation assumed the operations of the Bureau on July 1, 2014, and substantially all of the operations are reflected in the Visit Houston expenses. In 2016, tourism and marketing initiatives were a continuing focus, which resulted in increased advertising, promotion, consulting and personnel expenses.

General and administrative expenses increased in 2016 by $4,021,650 to $42,356,188 from $38,334,538 in 2015. The majority of this increase is attributable to increased personnel costs as a result of an increase in headcount as well as an increase in convention services agreement costs described in Note 12.

Total operating expenses increased $28,917,289 to $149,419,266 in 2015 from $120,501,977 in 2014. The increase was primarily due to an increase in hotel expenses and Visit Houston expenses, with smaller increases in general and administrative expenses and enterprise development expenses.

Hotel expenses increased $4,771,900 to $38,575,885 in 2015 from $33,803,985 in 2014. This increase was primarily driven by variable costs, which correlate with the increase in room and food and beverage revenue.

Visit Houston expenses increased $11,493,845 to $18,285,946 in 2015 from $6,792,101 in 2014. The Corporation assumed the operations of the Bureau on July 1, 2014, and substantially all of the operations are reflected in the Visit Houston expenses. The 2015 expenses represent a full year of operations, compared to six months in 2014. In addition, new tourism initiatives, were launched in 2015, which resulted in increased advertising, personnel and consulting expenses.

General and administrative expenses increased in 2015 by $5,160,979 to $38,334,538 from $33,173,559 in 2014. The majority of this increase is the result of temporary office space being leased in 2015 during the construction of the Convention District Project. In addition, hotel personnel costs increased for sales incentives benefit costs, and new sales positions added in 2015.

Enterprise development expenses increased $3,010,145 in 2015 to $3,592,056 from $581,911 in 2014. The increase reflects the Bureau operations other than Visit Houston for a full year in 2015, compared to six months in 2014. In addition, initiatives to explore new partnership opportunities were introduced in 2015, increasing consulting and personnel expenses.

The Corporation's operating loss, which includes the noncash charge of depreciation, totaled $41,461,725 and $21,729,222 in 2016 and 2015, respectively.

The Corporation's operating income (loss), which includes the noncash charge of depreciation, totaled ($21,729,222) and $2,281,305 in 2015 and 2014, respectively.

5. Sponsorship Expense

Sponsorship expenses increased $3,745,873 to $7,834,968 in 2016 from $4,089,095 in 2015. This increase is primarily from the Corporation's support for events such as NCAA Final Four and Super Bowl, along with support for museums and performing arts centers.

6. Transfers to Primary Government

In the Consolidation Interlocal Agreement, the Corporation agreed to make certain payments to the City for obligations previously paid directly by the Department. At December 31, 2016, 2015 and 2014, these payments totaled $18,064,748, $18,645,234, and $18,831,423, respectively. As one of these payments is based on HOT revenues, the decrease of $580,486 in 2016 and the decrease of $186,189 in 2015 were directly related to the corresponding decline in HOT revenues for those respective years.

7. Interest Expense

Interest expense decreased $1,474,139 in 2016 to $8,512,175 in 2016 from $9,986,314 in 2015. The decrease in interest expense is primarily due to capitalization of interest costs on construction and interest rate decreases on the new debt offerings.

Interest expense decreased $1,722,165 in 2015 to $9,986,314 from $11,708,479 in 2014. The decrease was primarily due to the capitalization of interest cost on construction projects of $4,615,700 offset by cost of issuance on 2015 refunding and interest on the new money debt offering.

8. Greater Houston Convention and Visitors Bureau (GHCVB) Contract Expense

GHCVB contract expense decreased $9,351,707 in 2015 to $-0- due to the Bureau Services Agreement effective July 1, 2014 as discussed previously.

9. Completion of Construction Projects

In December of 2016, the Corporation concluded a major 36-month redesign and reconfiguration of the Convention District. The construction project was undertaken to create a space where people would congregate, one that would complement and integrate the nearby green space and one that would overcome the car-centric design prevalent in Houston. The approximately $172 million of projects included enhancements to the George R. Brown Convention Center, the streetscape directly in front and an office building and garage.

George R. Brown Convention Center

This approximately $48.5 million project created a 100,000-square-foot first floor concourse and atrium-like lobby. Highlighted by floor to ceiling glass walls looking out onto Discovery Green, the new space is not only functional for meetings, registration and events, it also provides literal transparency, allowing those inside to see the beauty of the park, the new Avenida Houston plaza, and the Downtown skyline, and those outside to see into the building and its activity. The project also connects the Convention Center via sky bridge to the new 1,100-room Marriott Marquis, creating a focal point between the Marquis and the 1,200-room Hilton Americas.

Avenida Houston

Outside of the Convention Center, the project created a new pedestrian plaza that runs the five blocks in front of the GRB. This area, and the broader area surrounding Discovery Green, is now called Avenida Houston. This was accomplished by eliminating several lanes of traffic in front of the Convention Center. The plaza is designed to tell the story of Houston's industrial and natural history, while creating the public square that the city has long needed. Within the landscaped plaza is the Wharf, an intimate special event space overlooking Discovery Green and the new *Wings Over Water* sculpture. The plaza space includes five new restaurants, four of which occupy space in the GRB.

Partnership Tower and Avenida North Garage

Located immediately north of the GRB, the seven-story, 127,000-square-foot Partnership Tower office building was designed to house the organizations responsible for marketing and promoting Houston. The building was substantially completed in September 2016.

With the office building, Houston First's goal was to encourage synergy between the major groups representing Houston that would result in improved promotion of the city. Tenants include the Greater Houston Partnership, the Hotel and Lodging Association of Greater Houston, the Harris County - Houston Sports Authority, Houston First and the Greater Houston Convention and Visitors Bureau. The building cost $41 million and the attached garage cost $59.3 million.

A 1,900-car garage connected to the east side of the office building serves the building itself, the GRB, the Marriott Marquis and the broader Avenida Houston. The garage was built with a transit center to accommodate buses that once dropped off convention attendees in front of the GRB. A similar transit center is also now at the south end of the GRB in the Avenida South garage. Both transit centers offer covered direct access to the GRB. METRO's new southeast rail line serves both sides of the tower along Rusk and Capitol streets.

The aforementioned projects combined with the financing assistance to Houston Convention Center Hotel, LLC were funded by $198 million from debt issuance and $36.1 million of cash from operations as described in Note 6. These investments were made in order to enhance the value of the City's Convention Center District, now rebranded as Avenida Houston, and to improve the marketability of Houston as a tourist and convention destination. All or most of these projects culminated in early February 2017, when Houston hosted Super Bowl LI. The new assets were integral in hosting a successful event during which over 150,000 out of town visitors enjoyed a full week of celebration where they experienced the hospitality of the culinary and cultural capital of the South.

HOUSTON FIRST CORPORATION
(A Component Unit of the City of Houston, Texas)

STATEMENTS OF NET POSITION
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 34,791,924	$ 91,410,914
Accounts receivable—net	19,123,480	13,194,395
Prepaid expenses and other assets	5,696,846	4,119,237
Deposits held by others—current	7,367,506	5,867,539
Short-term equity in pooled investments	52,913,492	97,454,939
Total current assets	119,893,248	212,047,024
NON-CURRENT ASSETS:		
Notes receivable	58,886,102	59,136,102
Equity in pooled investments—restricted	19,843,207	19,619,945
Property, plant, and equipment—net	397,794,838	327,368,487
Other assets—net	11,970,101	7,479,397
Total non-current assets	488,494,248	413,603,931
TOTAL ASSETS	608,387,496	625,650,955
DEFERRED OUTFLOW OF RESOURCES—Deferred amounts from debt refunding	4,550,440	4,068,253
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	19,369,368	25,093,296
Accrued interest	3,086,565	3,235,898
Accrued expenses	17,458,245	15,939,980
Due to City of Houston	4,772,021	2,890,582
Subordinated management fee	850,000	850,000
Current portion of notes payable	12,200,278	10,968,470
Current portion of unearned revenue	416,443	426,443
Total current liabilities	58,152,920	59,404,669
LONG-TERM LIABILITIES:		
Notes payable	394,171,533	406,170,934
Unearned revenue	8,397,792	8,734,827
Total long-term liabilities	402,569,325	414,905,761
Total liabilities	460,722,245	474,310,430
COMMITMENTS AND CONTINGENCIES (Notes 8, 10, 11 and 12)		
NET POSITION		
Net investment in capital assets	71,527,793	29,783,995
Restricted for debt service	407,989	-
Unrestricted	80,279,909	125,624,783
TOTAL NET POSITION	$ 152,215,691	$ 155,408,778

See notes to the financial statements.

HOUSTON FIRST CORPORATION

(A Component Unit of the City of Houston, Texas)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
OPERATING REVENUES:		
Hotel revenues	$ 91,282,156	$ 99,806,481
Venue revenues	17,322,227	16,794,009
Parking revenues	8,280,885	7,732,451
Other operating revenues	3,107,604	3,357,103
Total operating revenues	119,992,872	127,690,044
OPERATING EXPENSES:		
Hotel expenses	39,011,230	38,575,885
Venue expenses	30,436,248	30,844,032
Parking expenses	9,573,253	9,409,365
Visit Houston expenses	24,482,295	18,285,946
General and administrative expenses	42,356,188	38,334,538
Enterprise development expenses	4,009,565	3,592,056
Depreciation and amortization	11,585,818	10,377,444
Total operating costs and expenses	161,454,597	149,419,266
OPERATING LOSS	(41,461,725)	(21,729,222)
NONOPERATING REVENUES (EXPENSES):		
Transfers from primary government	72,152,657	74,135,879
Sponsorship expense	(7,834,968)	(4,089,095)
Transfers to primary government	(18,064,748)	(18,645,234)
Interest expense	(8,512,175)	(9,986,314)
Interest income	527,872	280,760
Total nonoperating revenues (expenses)	38,268,638	41,695,996
(DECREASE) INCREASE IN NET POSITION	(3,193,087)	19,966,774
NET POSITION—Beginning of year	$ 155,408,778	$ 135,442,004
NET POSITION—End of year	$ 152,215,691	$ 155,408,778

See notes to the financial statements.

HOUSTON FIRST CORPORATION
(A Component Unit of the City of Houston, Texas)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$114,799,935	$121,268,287
Cash payments to suppliers for goods and services	(96,400,242)	(87,042,667)
Cash payments to employees for services	(58,035,118)	(54,272,123)
Cash transfers from the City per agreements	73,489,427	83,858,787
Cash payments to the City per agreements	(18,064,748)	(18,645,234)
Cash payments for sponsorships	(7,834,968)	(4,089,095)
Net cash provided by operating activities	7,954,286	41,077,955
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Payments for interest	(2,995,372)	(3,781,763)
Net cash used in non-capital financing activities	(2,995,372)	(3,781,763)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Payments for interest	(7,755,916)	(11,756,223)
Principal payment on note payable	(9,160,000)	(8,820,000)
Proceeds from debt financing	-	37,005,510
Payment for debt issuance costs	-	(864,858)
Payment for deposits held by others	(1,499,967)	(2,055,076)
Acquisition of property, plant, and equipment	(88,008,084)	(90,307,135)
Net cash used in capital and related financing activities	(106,423,967)	(76,797,782)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans to others	-	(26,982,881)
Interest received on investments	251,571	154,785
Purchase of investments	(19,806,212)	(75,122,699)
Proceeds from sales and maturities of investments	64,400,704	163,428,696
Net cash provided by investing activities	44,846,063	61,477,901
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(56,618,990)	21,976,311
CASH AND CASH EQUIVALENTS—Beginning of year	91,410,914	69,434,603
CASH AND CASH EQUIVALENTS—End of year	$ 34,791,924	$ 91,410,914

(Continued)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
RECONCILIATION OF OPERATING (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating (loss)	$ (41,461,725)	$ (21,729,222)
Adjustments to reconcile operating (loss) to net cash provided by operating activities:		
Depreciation and amortization	11,585,818	10,377,444
Increase in accounts receivable—net	(5,929,085)	(9,265,310)
Increase in prepaid expenses and other assets	(1,577,609)	(2,393,251)
(Increase) decrease in other assets	(4,240,704)	289,645
Increase (decrease) in accounts payable	816,652	(1,544,031)
Increase in accrued expenses	1,518,263	4,465,849
Increase in due to primary government	1,881,439	10,039,752
Decrease in unearned revenue	-	(247,627)
Nonoperating income (expenses):		
Transfers from City	72,152,657	74,135,879
Other City obligations	(18,609,417)	(18,962,078)
Sponsorship expense	(7,834,968)	(4,089,095)
Decrease in deferred revenue	(347,035)	-
Net cash provided by operating activities	$ 7,954,286	$ 41,077,955
NONCASH TRANSACTIONS:		
Fair market value adjustment related to investments	$ 60,190	$ (37,705)

See notes to the financial statements.

(Concluded)

1. ORGANIZATION

Houston First Corporation (the "Corporation") (formerly, Houston Convention Center Hotel Corporation (the "Hotel Corporation")), a component unit of the City of Houston, Texas (the "City"), was formed on February 18, 2000, under the provisions of Chapter 431, Subchapter D of the Texas Transportation Corporation Act, and Chapter 394, Vernon's Texas Codes Annotated, Local Government Code. The purpose of the Hotel Corporation was to aid and act on behalf of the City in establishing, constructing, improving, enlarging, equipping, repairing, operating, or maintaining (any or all) a 1,200-room convention center hotel in downtown Houston (such hotel to be within 1,000 feet of the George R. Brown Convention Center (the "Convention Center")) (the "Hotel") and a parking garage (the "Parking Garage") for approximately 1,600 vehicles adjacent to the Hotel. The Hotel was completed in 2003 and opened on December 4, 2003.

On June 1, 2011, City's city council (the "City Council") approved the consolidation of the City's Convention & Entertainment Facilities Department (the "Department") into the Hotel Corporation (the "Consolidation"), effective July 1, 2011, in order to improve the coordination of the City's convention and entertainment services by bringing various entities responsible for generating and spending City hotel occupancy tax ("HOT") revenues under one governing body. In connection with the Consolidation, the Hotel Corporation reconstituted and renamed itself as "Houston First Corporation," and Houston First Corporation assumed the primary roles and responsibilities of the Department. To accomplish this, the Hotel Corporation amended its bylaws and articles of incorporation to broaden its authority to accomplish its expanded duties and responsibilities. The Corporation has the authority to exercise all rights and privileges of a Texas nonprofit corporation and, as a governmental unit within the meaning of Chapter 101 of the Texas Civil Practice Remedies Code, its operations are governmental and not proprietary functions. The Corporation is governed by the board of directors appointed and approved by the mayor and City Council.

The Corporation (a) leases all previously existing Department facilities and Department-managed facilities; (b) operates, manages, maintains, develops, and redevelops those existing facilities; (c) has been assigned and now administers all of the Department's obligations and responsibilities, as well as its revenue budgeted as part of the Department's budget, including, but not limited to, municipal HOT receipts, license fees, and concession revenues; and (d) as the City's agent, collects, administers, and audits HOT funds in accordance with terms of City ordinances. The Corporation currently has no employees but has entered into various contracts to provide the personnel and expertise required to operate its facilities. The City has entered into an interlocal agreement with the Corporation (the "Consolidation Interlocal Agreement"), whereby the Corporation will pay $1,380,000 per year to lease all existing Department facilities and Department-managed facilities. The Corporation also agreed to pay the City a one-time fee of $8,620,000 during the City's fiscal year 2012 from operating revenues of the Hotel. The Consolidation Interlocal Agreement's initial term expires on December 31, 2026, but will be extended automatically until June 30, 2041, unless canceled by either party on or before June 30, 2026.

The Corporation is presented as a discretely presented component unit of the City (legally separate from the City). Board members are appointed by the mayor of the City and confirmed by the City Council.

On March 4, 2013, the Corporation formed Houston First Holdings, LLC (HFH), a wholly owned subsidiary of the Corporation, as a “special-purpose” entity for the purpose of owning, holding, selling, leasing, transferring, exchanging, operating, managing, and otherwise dealing with the property known as the Hilton Americas–Houston and its parking garage. The subsidiary is included in the financial statements of the Corporation and all intercompany accounts and transactions are eliminated in consolidation.

On June 18, 2014, the Corporation entered into a Services Agreement with the Greater Houston Convention and Visitors Bureau (“the Bureau”) which engaged the Corporation to provide advertising and promotional programs on behalf of the Bureau at a minimum of the same levels as previously funded by the Corporation to the Bureau. The Bureau’s employees have been added to the Corporation’s existing personnel contracts effective July 1, 2014. The Services Agreement required the Corporation to amend the Certificate of Formation to increase the number of authorized board members from 11 to 13. The expenses incurred as a result of the Services Agreement are included in operating expenses as Visit Houston expenses.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The financial statements of the Corporation have been prepared on the accrual basis of accounting, a flow of economic resources measurement focus. Under the measurement focus, resources are recognized in the period earned, and expenses are recognized in the period incurred.

The Corporation defines operating revenues and expenses consistent with the precepts of Statement of Government Accounting Standards No. 9 paragraphs 16-19 and 31. Generally, receipts collected or due from customers for providing services are considered operating revenues. The payments or amounts due to provide these services are considered operating expenses. All other receipts and payments are considered nonoperating. The significant accounting policies are described below.

Cash and Cash Equivalents—The Corporation defines cash and cash equivalents as cash and investments that are highly liquid, with less than three-month maturities when purchased.

Accounts Receivable—Accounts receivable are stated at the historical carrying amount net of an allowance for uncollectible accounts. An allowance for uncollectible accounts receivable has been established based on historical experience and any specific customer collection issues that have been identified. Uncollectible accounts receivable are written off when a settlement is reached for an amount that is less than the outstanding historical balance or when management has determined that the balance will not be collected. The allowance for doubtful accounts totaled $475,639 and $40,843 at December 31, 2016 and 2015, respectively.

Prepaid Expenses—Prepaid expenses include prepaid insurance, interest, and other miscellaneous prepaid expenses. Prepaid insurance is expensed on a straight-line basis over the period of the coverage.

Investments—The Corporation participates in a City investment pool managed internally by City personnel. The investment funds are administered using a pooling concept, which combines the monies of various City funds for investment purposes (the "City's Investment Pools"). The Corporation's pro rata share of participation in the City's Investment Pools is displayed in the statements of net position as "Equity in pooled investments" held by the City in accordance with the Governmental Accounting Standards Board (GASB or the "Board") Accounting Standards Codification on Accounting and Financial Reporting for Certain Investments for External Investment Pools and are carried at fair value. The fair value adjustment is included as part of interest income. The Corporation is apportioned interest earnings from the City's investment pools based upon the Corporation's relative pro rata share of the applicable investment pool. All of the Corporation's funds in the City's investment pools are restricted for debt service.

Property, Plant, and Equipment—Property, plant, and equipment are recorded at original cost for items purchased. Capital assets are defined as assets with an initial cost of $500 or more for Hotel operation and $5,000 or more for others, and an estimated useful life in excess of one fiscal year. Ordinary maintenance and repairs are charged to expense when incurred. Expenditures related to the development of real estate are carried at cost, plus capitalized carrying charges.

Management reviews its long-lived assets for impairment whenever events indicate that the carrying amount of an asset may not be recoverable. If there is an indication of impairment, management prepares an estimate of future undiscounted cash flows (without interest charges) expected to result from the use of the asset and its eventual disposition. If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the asset to its estimated fair value. Preparation of estimated expected future cash flows is inherently subjective and is based on management's best estimate of assumptions concerning expected future conditions. Impairment loss of $112,534 was recognized by the Corporation during the year ended December 31, 2015. There were no impairment changes recognized by the Corporation during the year ended December 31, 2016.

Depreciation—Depreciation is provided on a straight-line basis over the estimated useful lives of the depreciable assets, ranging from three to 39 years.

Capitalized Interest—The Corporation capitalizes interest expense on qualifying construction in progress expenditures based on an imputed interest rate estimating the Corporation's average cost of borrowed funds. Such capitalized interest becomes part of the cost of the related asset and is depreciated over its estimated useful life. The Corporation recorded capitalized interest totaling $5,163,294 and $4,615,700 for the years ended December 31, 2016 and 2015, respectively.

Debt Issuance Costs/Notes Payable—Premiums and discounts included in notes payable are amortized as a component of interest expense over the applicable term using the effective interest method. Debt issuance costs are expensed when incurred.

Unearned Revenue—A parcel of land was conveyed to the Corporation by the City for the construction of the Hilton Parking Garage (the "Parking Garage"), which is attached to the Hotel. The cost of the land was included as unearned revenue at the City's recorded cost of

$3,144,362. In addition, the City made a grant to the Corporation in the amount of $10 million, which provides the City the right to use up to one-half of the spaces available in the Parking Garage and to share in the net income of the parking proceeds in perpetuity. This right was transferred to the Corporation upon formation.

The Corporation recognizes the unearned revenue as garage revenue ratably over the estimated 39-year useful life of the Parking Garage. Amortization of unearned revenue during the years ended December 31, 2016 and 2015 totaled $337,035 which is included in garage revenues.

Revenue Recognition—Service and other sales revenues are recognized when services are rendered or when revenue is earned, net of sales tax.

Transfers from Primary Government—As part of the Consolidation Interlocal Agreement, the City assigned to the Corporation the net available pledged revenues to pay for operating expenses, capital expenditures, and for any other lawful purpose, and they are shown as "Transfers from primary government." The amount transferred from the Department was $72,152,657 and $74,135,879 for 2016 and 2015, respectively, and represents the HOT and parking revenues remaining after debt service and other related expenses were paid.

Transfers to Primary Government—As part of the Consolidation Interlocal Agreement, the Corporation agreed to make certain payments to the City for obligations previously paid directly by the Department. At December 31, 2016 and 2015, these payments totaled $18,064,748 and $18,645,234, respectively.

Income Taxes—The Corporation is exempt from federal income tax under Section 115(1) of the Internal Revenue Code of 1986.

Effective for taxable years beginning on January 1, 2007, the State of Texas enacted the Revised Texas Franchise Tax, which imposes a tax at the entity level. The Corporation is exempt from the Revised Texas Franchise Tax.

Use of Estimates in Financial Statement Preparation—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosures. The Corporation's consolidated financial statements include amounts that are based on management's best estimates and judgments. Actual results could differ from those estimates.

New Accounting Pronouncements—In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application.* The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. The Corporation determined there has been no effect upon its financial position, results of operations, or cash flows upon adoption. Disclosures required by this statement are included in Note 4.

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosure*. Tax abatements are widely used by state and local governments, particularly to encourage economic development. For financial reporting purposes, this Statement defines tax abatement as resulting from an agreement between a government and an individual or entity. In the agreement, the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens. This Statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. The provisions of this statement are effective for reporting periods beginning after December 15, 2015. The Corporation has implemented this statement and required disclosures are included in Note 12.

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participant.* This statement establishes criteria for external investment pools to qualify to make the election to measure all of its investments at amortized cost for financial statement purposes. It also establishes additional note disclosures for qualifying external investment pools and their participants. The provisions of this statement are effective for reporting periods beginning after June 15, 2015. The Corporation has determined there has been no effect upon its financial position, results of operations, or cash flows upon adoption.

In March of 2017, the GASB issued Statement No. 85, *Omnibus 2017*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB). The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged. The Corporation has not yet determined the effect upon its financial position, results of operations, or cash flows upon adoption.

In May of 2017 GASB issued Statement No. 86, *Certain Debt Extinguishments Issues*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and the notes disclosures for debt that is defeased in substance. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged. The Corporation has not yet determined the effect upon its financial position, results of operations, or cash flows upon adoption.

3. CASH AND CASH EQUIVALENTS

The Corporation's investment policy requires all deposits to be fully collateralized with depository insurance, obligations of the United States or its agencies, and instrumentalities (excluding those mortgage-backed securities prohibited by the State of Texas Public Funds Investment Act), or in any other manner and amount provided by law for the deposits of the Corporation.

The Corporation's cash and cash equivalents balance of $34,791,924 and $91,410,914 as of December 31, 2016 and 2015, respectively, are maintained in cash, demand accounts, and money market mutual funds. The accounts that comprise this balance are described below:

	2016	2015
Demand deposit accounts	$ 26,405,225	$ 90,338,260
Cash on hand	126,447	153,542
Money market	8,260,252	919,112
Total	$ 34,791,924	$ 91,410,914

The demand deposit accounts are either fully collateralized by the depository institution primarily in direct obligations of the U.S. government or its agencies, or insured by the Federal Deposit Insurance Corporation. The money market account is the sweep balance of one of the demand deposit accounts. It is held with a mutual fund managed by Bank of America and invests primarily in direct obligations of the U.S. government or its agencies and is uninsured.

4. EQUITY IN POOLED INVESTMENTS

Short-term Equity in Pooled Investments—As of December 31, 2016 and 2015, the Corporation's pooled investments included $52,913,492 and $97,454,939, respectively, invested in the Texas Short-Term Asset Reserve Program ("TexSTAR"). TexSTAR was created in April 2003, under the Interlocal Cooperation Act of the State of Texas Article 4413 (32C), Vernon's Texas Civil Statutes, as amended. It is administered by First Southwest Asset Management, Inc., and JP Morgan Chase. The fund is rated AAm by Standard & Poor's. The TexSTAR investment pools' investments are not evidenced by securities that exist in physical or book entry form and, accordingly, do not have custodial risk.

As with all the investment pools, funds are readily available to support daily cash requirements, while maintaining yields slightly higher than standard bank deposit accounts.

Equity in Pooled Investments—Restricted—The City issued bonds in 2001, 2011, 2012, 2014, and 2015, a portion of which was for the benefit of the Corporation to fund construction, interest, and operating expenses incurred during the construction of the Hotel, the Convention District Projects, and the Development and Funding Agreement discussed in Note 8. Certain proceeds were designated as debt service reserve funds to be used by the Corporation to service the debt during the initial months of the Hotel's operations and during periods of decreased operational liquidity. In addition, the Corporation makes monthly payments to the City to fund the semiannual bond payments made by the City. These funds are designated as debt service funds. All above-referenced funds are held in the City's investment pools. The balance of such accounts at December 31, 2016 and 2015, totaled $19,843,207 and $19,619,945, respectively.

As of December 31, 2016 and 2015, the Corporation's exposure to interest rate risk as measured by the segmented time distribution by investment type is summarized below:

	December 31, 2016 Fair Value	Investment Maturities in Years Less than 1	1–5
City of Houston General Pool	$ 19,843,207	$ -	$ 19,843,207
TexSTAR	52,913,492	52,913,492	-
Total Investment Pools	$ 72,756,699	$ 52,913,492	$ 19,843,207

	December 31, 2015 Fair Value	Investment Maturities in Years Less than 1	1–5
City of Houston General Pool	$ 19,619,945	$ -	$ 19,619,945
TexSTAR	97,454,939	97,454,939	-
Total Investment Pools	$ 117,074,884	$ 97,454,939	$ 19,619,945

The Corporation's exposure to credit risk at December 31, 2016 and 2015 is presented below by investment category as rated by Standard & Poor's and Fitch:

	December 31, 2016 Fair Value	Rating
City of Houston General Pool	$ 19,843,207	AAA by Fitch
TexSTAR	52,913,492	AAAm by Standard & Poor's
Total Investment Pools	$ 72,756,699	

	December 31, 2015 Fair Value	Rating
City of Houston General Pool	$ 19,619,945	AAA by Fitch
TexSTAR	97,454,939	AAAm by Standard & Poor's
Total Investment Pools	$ 117,074,884	

Fair Value Measurements—The Corporation is required to disclose the fair value level of its investments within the fair value hierarchy established by GASB No. 72. In the fair value hierarchy, there are three levels:

1. Level one: inputs that are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date

2. Level two: inputs (other than quoted prices included within level one) that are observable for an asset or liability, either directly or indirectly

3. Level three: unobservable inputs for an asset or liability

The Corporation invests in both the City of Houston general pool and TexStar investment pool. A summary of the City of Houston general pool's investment under the requirements of the fair value hierarchy follows:

Fair Value Measurements

	December 31, 2016	Level 1	Level 2
U.S Treasury Securities	$ 1,722,339,380	$ 1,722,339,380	$ -
Government Agency Securities	1,004,783,103		1,004,783,103
Government Mortgage Backed Securities	19,587,428		19,587,428
Municipal Securities	295,739,423		295,739,423
Commercial Paper	99,763,000		99,763,000
Certificate of Deposit	126,207,410	-	126,207,410
Total	$ 3,268,419,744	$ 1,722,339,380	$ 1,546,080,364

Debt securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique provided by third party custodians. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

TexSTAR uses the fair value method to report its investments and is classified as Level 2 of the fair value hierarchy. Under the fair value method, fixed income securities are valued each day by independent or affiliated commercial pricing services or third party broker-dealers. In instances where sufficient market activity exists, the pricing services or broker-dealers may utilize a market-based approach through which quotes from market makers are used to determine fair value. In instances where sufficient market activity may not exist or is limited, the broker-dealers or pricing services also utilize proprietary valuation models which may consider market transactions in comparable securities and the various relationships between securities in determining value and/or market characteristics such as benchmark yield curves, option adjusted spreads, credit spreads, estimated default rates, coupon-rates, anticipated timing of principal repayments, underlying collateral, and other unique security features in order to estimate the relevant cash flows, which are than discounted to calculate the fair values.

5. DEPOSITS HELD BY OTHERS

As discussed in Note 8, the Corporation closed a $125,000,000 mortgage loan with VALIC, ("the Mortgage Loan"), which is secured by a deed of trust on the Hilton, its parking garage, the improvements located thereon, and certain personal property. In consideration of the Mortgage Loan, VALIC required the Corporation to fund certain reserves to be held with their agent. The reserves represent the subordinated management fee and the deferred fee from Hotel Operator as discussed in Note 10, and a reserve for furniture, fixtures, and equipment replacement and renewal. As more fully described in Note 10, the termination of the former Hotel Management Agreement in 2014 caused a corresponding release of the subordinated management fee reserves. As of December 31, 2016 and 2015, the deposits held by others included in the statements of net position totaled $7,367,506 and $5,867,539, respectively.

6. NOTES RECEIVABLE AND DUE FROM AFFILIATE

As more fully described in Note 10, the Corporation entered into a Development and Funding Agreement with Houston Convention Center Hotel, LLC ("Hotel Owner"), for the development of an approximately 1,000-room hotel facility. In accordance with this agreement, in April 2013, the Corporation loaned funds to Houston First Foundation ("HFF"), a Texas nonprofit and related party, to enable HFF to purchase the hotel site land.

On April 14, 2014, HFF sold the hotel site land to the Hotel Owner. As a result, the Corporation swapped HFF's portion of the loan to the Hotel Owner for the receivable from HFF. The Corporation also transferred $27 million to an escrow account to fund its required obligation to the Hotel Owner. As of December 31, 2015, the escrow account was fully disbursed; the total receivable from the Hotel Owner to the Corporation was $59,136,102, with $250,000 reported in prepaid and current asset in the consolidated balance sheet.

Based on the opening of the new hotel during 2016, the scheduled payments on the loan are as follows:

Years Ending December 31	**Total Payments**
2017	$ 250,000
2018	250,000
2019	250,000
2020	250,000
2021	250,000
2022-2026	1,250,000
2027-2031	2,500,000
2032-2036	4,000,000
2037-2041	7,500,000
2042-2046	7,500,000
2047-2051	8,000,000
2052-2056	10,000,000
2057-2061	10,000,000
2062-2065	7,136,102
Total	$ 59,136,102

7. PROPERTY, PLANT, AND EQUIPMENT—NET

The changes in the Corporation's property, plant, and equipment for the years ended December 31, 2016 and 2015, were as follows:

	January 1, 2016	Additions/ Transfers	Retirements/ Transfers	December 31, 2016
Property, plant, and equipment, not subject to depreciation:				
Land	$ 14,824,298	$ -	$ -	$ 14,824,298
Construction in progress	108,637,141	82,507,940	(109,179,131)	81,965,950
Total property, plant, and equipment, not subject to depreciation	123,461,439	82,507,940	(109,179,131)	96,790,248
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	274,028,965	103,980,047	-	378,009,012
Furnishings and equipment	41,072,166	4,703,314	-	45,775,480
Total property, plant, and equipment, subject to depreciation	315,101,131	108,683,361	-	423,784,492
Less accumulated depreciation for:				
Hotel and garage buildings	(79,578,653)	(8,695,750)	-	(88,274,403)
Furnishings and equipment	(31,615,430)	(2,890,068)	-	(34,505,498)
Total accumulated depreciation	(111,194,083)	(11,585,818)	-	(122,779,901)
Total property, plant, and equipment—net	$ 327,368,487	$ 179,605,483	$ (109,179,131)	$ 397,794,838

	January 1, 2015	Additions/ Transfers	Retirements/ Transfers	December 31, 2015
Property, plant, and equipment, not subject to depreciation:				
Land	$ 14,824,298	$ -	$ -	$ 14,824,298
Construction in progress	22,934,118	86,016,735	(313,712)	108,637,141
Total property, plant, and equipment, not subject to depreciation	37,758,416	86,016,735	(313,712)	123,461,439
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	256,487,407	9,231,309	8,310,249	274,028,965
Furnishings and equipment	45,461,384	3,992,801	(8,382,019)	41,072,166
Total property, plant, and equipment, subject to depreciation	301,948,791	13,224,110	(71,770)	315,101,131
Less accumulated depreciation for:				
Hotel and garage buildings	(71,536,197)	(8,088,650)	46,194	(79,578,653)
Furnishings and equipment	(29,326,636)	(2,288,794)	-	(31,615,430)
Total accumulated depreciation	(100,862,833)	(10,377,444)	46,194	(111,194,083)
Total property, plant, and equipment—net	$ 238,844,374	$ 88,863,401	$ (339,288)	$ 327,368,487

8. NOTES PAYABLE

The Corporation's notes payable and related premium for the years ended December 31, 2016 and 2015 were as follows:

	January 1, 2016	Retirements/ Amortization	Additions	December 31, 2016
Notes payable				
Notes payable—City of Houston	$ 271,370,000	$ (9,160,000)	$ -	$ 262,210,000
Premium—net of discount	20,769,403	(1,607,592)	-	19,161,811
Total notes payable COH	292,139,403	(10,767,592)	-	281,371,811
Note payable—VALIC	125,000,000	-	-	125,000,000
Total notes payable	$ 417,139,403	$ (10,767,592)	$ -	$ 406,371,811

	January 1, 2015	Retirements/ Amortization	Additions	December 31, 2015
Notes payable				
Notes payable—City of Houston	$ 256,015,000	$ (8,820,000)	$ 24,175,000	$ 271,370,000
Premium—net of discount	10,803,511	(2,864,618)	12,830,510	20,769,403
Total notes payable COH	266,818,511	(11,684,618)	37,005,510	292,139,403
Note payable—VALIC	125,000,000	-	-	125,000,000
Total notes payable	$ 391,818,511	$ (11,684,618)	$ 37,005,510	$ 417,139,403

Payment of the Corporation's notes payable to the City is based on the amortization of the City hotel-allocated bonds and HFC-allocated bonds. The Variable Annuity Life Insurance Company (VALIC) loan requires monthly interest payments only until maturity on May 1, 2020. Scheduled principal and interest payments on debt are summarized as follows:

Years Ending December 31	Principal	Interest	Total
2017	$ 10,130,000	$ 15,470,488	$ 25,600,488
2018	10,170,000	14,989,075	25,159,075
2019	10,670,000	14,717,398	25,387,398
2020	135,870,000	10,693,233	146,563,233
2021	11,705,000	8,518,780	20,223,780
2022-2026	65,680,000	36,393,445	102,073,445
2027-2031	77,300,000	23,218,100	100,518,100
2032-2036	45,190,000	9,116,756	54,306,756
2037-2041	14,835,000	2,974,750	17,809,750
2041-2045	5,660,000	459,000	6,119,000
Total	$ 387,210,000	$ 136,551,025	$ 523,761,025

On August 31, 2011, the City issued Convention & Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2011A and 2011B. The bonds mature in varying amounts from 2012 to 2033. The Series B Bonds were hotel-allocated bonds, and the proceeds were used to refund the hotel-allocated portion of the City's Hotel Occupancy Tax and Special Revenue Bonds, Series 2001A, a portion of the Series 2001B, to convert a portion of the Series 2001C variable-rate debt to fixed-rated debt, and to fund an additional deposit to the debt service reserve fund. The Corporation's notes payable was similarly affected.

On April 3, 2013, the Corporation closed a $125,000,000 mortgage loan with VALIC, which is secured by a deed of trust on the Hilton, its parking garage, the improvements located thereon, and certain personal property. The proceeds were used to further economic development in and around the Convention Center and the Hilton, including a new 1,000-room convention center hotel, and to fund the Convention District Projects including a new 1,900-space parking garage, and certain other residential and retail opportunities to be located on the north end of the Convention Center.

The initial loan advance of $50,000,000 was funded on April 4, 2013, at an initial interest rate ("Initial Interest Rate") of 3.9%. In March 2014, an additional $30,000,000 was drawn and bears interest at 4.78%. In July 2014, the final draw of $45,000,000 was funded and bears interest at 4.81%. The interest rates are effective through maturity.

In August 2014, the City issued $73,725,000 of Convention & Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2014. This issue included $52,195,000 of Serial Bonds with stated interest rates between 2% and 5% maturing in various amounts from 2015 to 2032, and $21,530,000 of Term Bonds with stated interest rates of 5% maturing in various amounts from 2033 to 2039. The true interest cost was 4%. Proceeds were used to (a) refund the City's Outstanding Convention & Entertainment Facilities Department Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2012; (b) finance certain project costs; and (c) pay the costs of issuance of the bonds. Net present value savings totaled $4.6 million or 11% of the refunded bonds.

On March 19, 2015, the City issued $132,590,000 of Convention & Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2015. This issue included $99,620,000 Serial Bonds with stated interest rates between 2% and 5% maturing in various amounts from 2015 to 2035, and $32,970,000 of Term Bonds with stated interest rates between 4% and 5% maturing in various amounts from 2035 to 2044. The true interest cost was 3.3%. Proceeds were used to (a) refund a portion of the City's outstanding Convention & Entertainment Facilities Department Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2011, (b) refund outstanding commercial paper, (c) finance certain project costs, and (d) pay the costs of issuance of the bonds. Net present value savings totaled $9.2 million or 13.1% of the refunded bonds.

Of the total $262,210,000 notes payable, $187,210,000 of the principal balance relates to the City's fixed-rate bonds and carries interest rates ranging from 1.5% to 5.25%. The remaining $75,000,000 relates to the City's variable rate bonds and is issued as seven-day auction rate securities, with 10% being the maximum interest rate permitted. The variable rate at December 31, 2016 and 2015 was approximately 0.85% and 0.45%, respectively. Fees on the variable-rate bonds are 0.07% per year for 2016 and 2015. Interest presented on the above payment schedule is calculated on the stated interest rate on the fixed-rate bonds and the interest rate as of December 31, 2016, on the variable-rate bonds, plus expenses, for a total variable rate of 0.92%.

9. SUMMARY OF CASH FLOWS FROM OPERATIONS APPLICATION PRIORITY

Cash flows from hotel operations shall be applied to the following items in the following order of priority:

- First, to the payment of the note payable due to the City pursuant to the amortization schedule after taking into account all credits for tax rebates;
- Second, an amount equal to the excess of the preferred return over the current-year note payment shall be applied first to expenses of the Department and then to the corporate reserve fund, up to its defined maximum amount;
- Third, to the primary capital replacement reserve;
- Fourth, to the subordinated portion of the management fee;
- Fifth, to the secondary capital replacement reserve; and
- Sixth, unless otherwise directed by the president of the Corporation, to the City for deposit into the Convention and Entertainment Development Fund.

10. COMMITMENTS AND CONTINGENCIES

Hotel Management Agreement—The Corporation entered into a hotel management agreement (the "Management Agreement") on March 21, 2001, with the Hilton Hotels Corporation (the "Hotel Operator"). The Management Agreement had a term of 15 years and commenced with the opening of the Hotel.

On October 1, 2014, the Corporation executed a Management Agreement Termination Agreement (the "Termination Agreement") to terminate the Management Agreement described above and executed a new Management Agreement (the "New Management Agreement") with the Hotel Operator for the Hilton, with an effective date of January 1, 2014. In connection with the Termination Agreement, the Hotel Operator released the Corporation from repayment of the unamortized inducement fee from the original agreement and the Corporation disbursed the accrued subordinated management fee. The New Management Agreement is effective for 15 years and, consistent with the original Management Agreement, the New Management Agreement provides for a base management fee of $1,900,000 and a subordinated management fee of $850,000 (collectively referred to as the "Management Fees"). The Management Fees adjust annually based on the percentage change in the competitive set's prior 12-month revenue per available room with the base fee to commence adjustment effective January 1, 2015 and the subordinate fee to commence adjustment effective January 1, 2017. The subordinate fee is also subject to sufficient operating cash flows (as defined) and any unpaid subordinated fees will accrue. Upon termination of the New Management Agreement, any unpaid subordinated fees will be due and payable.

Preferred Return—In accordance with the Consolidation Interlocal Agreement and the Management Agreement, after meeting certain other funding and reserve requirements, the City can require the distribution of a preferred return from available cash flow (as defined) equal to the preferred return amount of $25 million per year, less the debt service for the applicable year. The preferred return is paid in the subsequent year and recorded as a distribution of net position when paid. In conjunction with the Consolidation, the preferred return payments are retained by the Corporation since the Department venues' operations were moved to the Corporation.

Development & Funding Agreement—On April 9, 2013, the Corporation entered into a Development and Funding Agreement with the Hotel Owner, for the development of an approximately 1,000-room new hotel facility located on the north end of the Convention Center. In accordance with the Development & Funding Agreement, the Corporation was obligated to a) design, construct, operate, and maintain a parking garage and skybridges; b) purchase the hotel site land; c) convey the hotel site land to the Hotel Owner; and d) subject to certain benchmarks, loan $27 million to the Hotel Owner. The Hotel Owner was obligated to a) design, construct, operate, and maintain the hotel facility and b) reimburse the Corporation no more than $62 million for the hotel site land and the loan commencing on January 5th of the year following opening of the hotel facility. See Note 6 above.

Leases Commitments—The Corporation is the lessor and sub-lessor of office space and retail space under various rental agreements that qualify as non-cancelable operating leases. The Partnership Tower is an office building that serves as the headquarters of the Corporation, with 43% of the building leased to other tenants. The building has a total cost of $40,434,547, accumulated depreciation of $42,465, and a carrying value of $40,392,081. In addition, 0.64% of the Hotel is leased to a retail tenant operating as a restaurant. The Hotel building has a total cost of $243,690,687, accumulated depreciation of $81,588,865, and a carrying value of $162,101,822. The sub lease agreements relate to assets that are leased from the City of Houston more fully described in Note 1. Future annual minimum rental income on all non-cancelable operating leases with a remaining term in excess of one year as of December 31, 2016 is as follows:

Year Ending December 31	Operating Leases
2017	$ 2,407,342
2018	2,627,725
2019	2,639,973
2020	2,690,333
2021	2,707,789
Thereafter	25,972,248

Certain rent concessions were granted in accordance with the aforementioned leases. Such concessions were capitalized and are being amortized on a straight line basis over the lease terms. As of December 31, 2016, the unamortized balance of rent concessions included in Other Assets-Net was $4,684,694. For the year ended December 31, 2016 amortization expense included in Venue revenues was $291,583. There were no rent concessions recorded as of December 31, 2015. Certain retail leases include contingent income that is earned when a percentage of the tenant's sales are higher than the minimum rent amount. Contingent income included in other operating revenues is $160,216 and $156,811 for the years ended December 31, 2015 and 2016.

11. RISK MANAGEMENT

As the owner of the Hotel operated as the Hilton, and as a local government corporation, the Corporation maintains, or has maintained on its behalf, various policies and/or insurance programs to cover the various risks of loss to which it is exposed. Through commercial policies, the following coverages have been secured: property, general liability, umbrella liability, auto, and theft. In lieu of a workers' compensation policy, the Hilton has procured a nonsubscriber program administered by a third-party administrator. Due to the division of responsibilities, the Corporation maintains separate policies for directors and officers, employment practices liability, crime, and property.

The Corporation is a defendant in various pending lawsuits arising out of the conduct of its business. Management does not believe that the outcome of any of these matters will have a material adverse effect on the Corporation's financial position, results of operations, or cash flows.

12. CONVENTION SERVICES AGREEMENTS

The Corporation has agreements with various hotels to rebate their Hotel Occupancy Tax. The purpose of these agreements is to encourage the development of hotels in the City's central business district, promote local economic development, and stimulate business and commercial. These agreements vary based on the hotel's proximity to the George R Brown Convention Center and other criteria determined by the Corporation, and require a room-block agreement. The room-block agreement grants the Corporation access to a specified number of room nights for use with city-wide events.

An agreement with Embassy Suites requires that 100% of their Hotel Occupancy Tax paid will be paid back to them. This agreement is valid until October 15, 2018. Embassy Suites has agreed to provide HFC with room-blocks for various events in exchange for this agreement.

An agreement with JW Marriott states that 50% of their Hotel Occupancy Tax paid will be paid back to them. This agreement is valid until March 20, 2019. JW Marriott has agreed to provide HFC with room-blocks for various events in exchange for this agreement.

The Corporation paid the following under the aforementioned agreements. Such amounts are included in venue expenses for the years ended December 31, 2016 and 2015.

	2016	2015
Embassy Suites	$ 915,788	$ 919,678
JW Marriott	666,828	104,070
Total	$ 1,582,616	$ 1,023,748

13. SUBSEQUENT EVENTS

The Corporation has evaluated subsequent events for potential recognition and/or disclosures through July 20, 2017, the date the financial statements were available to be issued.

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