

# Houston First Corporation

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

Financial Statements as of and for the Years  
Ended December 31, 2017 and 2016, 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, 2017 and 2016, 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, 2017 and 2016, 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 3-10 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*

June 27, 2018

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
**AS OF DECEMBER 31, 2017 AND 2016**

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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, 2017 and 2016, 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. The expenses incurred as a result of the Services Agreement are included in operating expenses as Visit Houston expenses.

For the years ended December 31, 2017 and 2016, 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 11 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 12 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 13-14 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 15-29 of this report.

## NET POSITION

Total net position at December 31, 2017 was \$73,078,192, a 51.99% decrease from December 31, 2016. Total net position at December 31, 2016 was \$152,215,691, a 2.05% decrease from December 31, 2015.

The Corporation's net position decreased \$79,137,499 to \$73,078,192 at December 31, 2017 from \$152,215,691 at December 31, 2016. Of this decrease, \$1,819,474 is attributable to a decrease in assets offset by an increase in liabilities of \$77,223,555, as described below.

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 by a decrease in liabilities of \$13,588,185, as described below.

### CONDENSED STATEMENTS OF NET POSITION DECEMBER 31, 2017, 2016 AND 2015

	December 31, 2017	December 31, 2016	December 31, 2015
Current assets	\$ 115,135,428	\$ 119,893,248	\$ 212,047,024
Noncurrent assets	90,238,084	90,699,410	86,235,444
Capital assets	<u>401,194,510</u>	<u>397,794,838</u>	<u>327,368,487</u>
Total assets	<u>\$ 606,568,022</u>	<u>\$ 608,387,496</u>	<u>\$ 625,650,955</u>
Deferred outflow of resources	<u>\$ 4,455,970</u>	<u>\$ 4,550,440</u>	<u>\$ 4,068,253</u>
Current liabilities	\$ 97,554,150	\$ 58,152,920	\$ 59,404,669
Long-term liabilities	<u>440,391,650</u>	<u>402,569,325</u>	<u>414,905,761</u>
Total liabilities	<u>\$ 537,945,800</u>	<u>\$ 460,722,245</u>	<u>\$ 474,310,430</u>
Net position	<u>\$ 73,078,192</u>	<u>\$ 152,215,691</u>	<u>\$ 155,408,778</u>

Total assets decreased \$1,819,474 to \$606,568,022 at December 31, 2017 from \$608,387,496 at December 31, 2016. This decrease is primarily the result of a decrease in accounts receivable and equity in pooled investments, offset by an increase in cash and cash equivalents and capital assets.

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 a decrease in equity in pooled investments and cash and cash equivalents, offset by an increase in accounts receivable and property, plant, and equipment.

Total liabilities increased \$77,223,555 to \$537,945,800 in 2017 from \$460,722,245 in 2016. The change is mostly attributable to new debt issued in 2017, offset by principal payments to the City of Houston for the HFC allocated bonds, premium amortization, and an increase in current liabilities caused by disaster expenses incurred by Hurricane Harvey. See the "Debt Issuance" section below for the details of each of the bonds that comprise the notes payable to the City.

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

### **Debt Issuance**

In August 2014, the City issued \$73,725,000 of Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2014. This issue included \$52,195,000 of serial bonds, with 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 (HOT) 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 totaled \$39,200,000.

On March 19, 2015, the City issued \$132,590,000 of HOT and Special Revenue Refunding Bonds, Series 2015. This issue included \$99,620,000 of serial bonds with 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 HOT 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. Net present value savings totaled \$9.2 million or 13.1% of the refunded bonds. New money proceeds totaled \$34,000,000.

On November 16, 2017, the City issued \$12,030,000 of Convention & Entertainment Facilities Department HOT and Special Revenue Refunding Bonds, Series 2017. This issue has a stated interest rate of 2.55% maturing in 2033. Proceeds were used to refund the City’s outstanding Convention & Entertainment Facilities Department HOT and Special Revenue Refunding Bonds, Series 2011B. Net present value savings totaled \$1.9 million or 16.5% of the refunded bonds.

On November 16, 2017, the City issued \$75,000,000 of Convention & Entertainment Facilities Subordinate Lien HOT and Parking Revenue Flexible Rate Notes, Series A. As of December 31, 2017, the City drew down \$50,000,000 of the notes.

The Corporation made principal payments totaling \$21,830,000 and \$9,160,000 in 2017 and 2016, respectively. The total notes payable balance includes the Corporation’s allocable portion of the unamortized bond premiums, net of discounts, which totaled \$16,968,553 and \$19,161,811 at December 31, 2017 and 2016, 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 \$18,756,244 and \$19,843,207 at December 31, 2017 and 2016, respectively.



**CONDENSED STATEMENTS OF CHANGES IN NET POSITION**  
DECEMBER 31, 2017, 2016, AND 2015

	December 31, 2017	December 31, 2016	December 31, 2015
OPERATING REVENUES:			
Hotel revenues	\$ 85,212,181	\$ 91,282,156	\$ 99,806,481
Venue revenues	21,894,656	17,322,227	16,794,009
Parking revenues	11,112,728	8,280,885	7,732,451
Other operating revenues	<u>3,164,259</u>	<u>3,107,604</u>	<u>3,357,103</u>
Total operating revenues	<u>121,383,824</u>	<u>119,992,872</u>	<u>127,690,044</u>
OPERATING EXPENSES:			
Hotel expenses	34,737,078	39,011,230	38,575,885
Venue expenses	31,071,598	30,436,248	30,844,032
Parking expenses	8,697,558	9,573,253	9,409,365
Visit Houston expenses	25,585,747	24,482,295	18,285,946
General and administrative	42,545,839	42,356,188	38,334,538
Enterprise Development	4,145,342	4,009,565	3,592,056
Hurricane Harvey costs	60,289,168	-	-
Depreciation and amortization	<u>16,254,144</u>	<u>11,585,818</u>	<u>10,377,444</u>
Total operating expenses	<u>223,326,474</u>	<u>161,454,597</u>	<u>149,419,266</u>
OPERATING LOSS	<u>(101,942,650)</u>	<u>(41,461,725)</u>	<u>(21,729,222)</u>
NONOPERATING REVENUES (EXPENSES):			
Transfers from primary government	67,132,522	72,152,657	74,135,879
Sponsorship expense	(16,685,953)	(7,834,968)	(4,089,095)
Transfers to primary government	(17,584,302)	(18,064,748)	(18,645,234)
Interest expense	(9,036,968)	(8,512,175)	(9,986,314)
Interest income	452,502	527,872	280,760
Loss on capital assets disposal	<u>(1,472,650)</u>	<u>-</u>	<u>-</u>
Total nonoperating revenues	<u>22,805,151</u>	<u>38,268,638</u>	<u>41,695,996</u>
CHANGE IN NET POSITION	(79,137,499)	(3,193,087)	19,966,774
NET POSITION—Beginning of year	<u>152,215,691</u>	<u>155,408,778</u>	<u>135,442,004</u>
NET POSITION—End of year	<u>\$ 73,078,192</u>	<u>\$ 152,215,691</u>	<u>\$ 155,408,778</u>

## **1. Operating Revenues**

Total operating revenues for 2017 and 2016 were \$121,383,824 and \$119,992,872, respectively, which represents a 1.16% increase of \$1,390,952. The majority of the increase in operating revenues for 2017 was attributable to increase in venue and parking revenues (Convention District parking garages) offset by a decrease in hotel revenue caused by continued weakness in the local economy.

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 was attributable to a decrease in hotel revenue and food and beverage revenue at the hotel caused by weakness in the local economy.

## **2. 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 2017, the amount transferred from the Department was \$67,132,522, a decrease of \$5,020,135 from 2016. 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. The decrease for all years is in direct correlation with HOT revenues and parking revenues from Theater District parking garages at the City.

## **3. Operating Expenses**

Total operating expenses increased \$61,871,877 to \$223,326,474 in 2017, from \$161,454,597 in 2016. The increase is primarily due to disaster expenses from Hurricane Harvey.

Hurricane Harvey costs relate to flood-related damage as a result of Hurricane Harvey and its aftermath. Cost increased \$60,289,168 in 2017, from zero in 2016. The properties damaged as a result of Hurricane Harvey are the Theater District Garages, Wortham Theater Center, and Jones Hall. The Theater District Garages and Jones Hall were temporarily closed but reopened in November 2017. Wortham Theater was closed and its planned reopening is September 2018. The majority of these costs are subject to reimbursement from the City of Houston, which is filing claims with Federal Emergency Management Agency (FEMA) and from insurance proceeds.

Hotel expenses decreased \$4,274,152 to \$34,737,078 in 2017, from \$39,011,230 in 2016. This decrease was primarily driven by variable costs, which correlate with the decrease in room and food and beverage revenue.

Depreciation expense increased \$4,668,326 to \$16,254,144 in 2017, from \$11,585,818 in 2016. The increase was mostly due to the depreciation of the George R Brown Convention Center (GRB) expansion and new garage, which were put in service in late 2016.

Total operating expenses increased \$12,035,331 to \$161,454,597 in 2016, from \$149,419,266 in 2015. The increase was 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.

The Corporation's operating loss, which includes the noncash charge of depreciation, totaled \$101,942,650, \$41,461,725, and \$21,729,222 in 2017, 2016 and 2015, respectively.

#### **4. Sponsorship Expense**

Sponsorship expense increased \$8,850,985 to \$16,685,953 in 2017, from \$7,834,968 in 2016. This increase is primarily from the Corporation's support for the Super Bowl event.

Sponsorship expense 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 the NCAA Final Four and the Super Bowl, along with support for museums and performing arts centers.

#### **5. 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, 2017, 2016, and 2015, these payments totaled \$17,584,302, \$18,064,748, and \$18,645,234, respectively. As the largest of these payments is based on HOT revenues, the decrease of \$480,446 in 2017 and the decrease of \$580,486 in 2016 were directly related to the corresponding decline in HOT revenues for those respective years.

#### **6. Interest Expense**

Interest expense increased \$524,793 in 2017 to \$9,036,968 in 2017, from \$8,512,175 in 2016. The increase is primarily due to the increase in notes payable and the cost of issuance from new debt offerings in 2017.

Interest expense decreased \$1,474,139 in 2016 to \$8,512,175, 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.

#### **7. 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 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 spans 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 ten-story, 139,000-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 Partnership Tower 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 Partnership 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 9. These investments were made in order to enhance the value of the City's Convention 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, 2017 AND 2016**

	2017	2016
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 37,227,796	\$ 34,791,924
Cash and cash equivalents—restricted	4,675,000	-
Accounts receivable—net	10,159,885	19,123,480
Prepaid expenses and other assets	6,295,950	5,696,846
Deposits held by others—current	5,468,164	7,367,506
Short-term equity in pooled investments	<u>51,308,633</u>	<u>52,913,492</u>
Total current assets	<u>115,135,428</u>	<u>119,893,248</u>
NON-CURRENT ASSETS:		
Notes receivable	58,636,102	58,886,102
Equity in pooled investments—restricted	18,756,244	19,843,207
Property, plant, and equipment—net	401,194,510	397,794,838
Other assets—net	<u>12,845,738</u>	<u>11,970,101</u>
Total non-current assets	<u>491,432,594</u>	<u>488,494,248</u>
TOTAL ASSETS	<u>606,568,022</u>	<u>608,387,496</u>
DEFERRED OUTFLOW OF RESOURCES—Deferred amounts from debt refunding	<u>4,455,970</u>	<u>4,550,440</u>
<b>LIABILITIES</b>		
CURRENT LIABILITIES:		
Accounts payable	47,493,602	19,369,368
Accrued interest	2,925,157	3,086,565
Accrued expenses	5,844,676	17,458,245
Due to City of Houston	27,766,612	4,772,021
Subordinated management fee	850,000	850,000
Current portion of notes payable	12,257,660	12,200,278
Current portion of unearned revenue	<u>416,443</u>	<u>416,443</u>
Total current liabilities	<u>97,554,150</u>	<u>58,152,920</u>
LONG-TERM LIABILITIES:		
Notes payable	432,330,893	394,171,533
Unearned revenue	<u>8,060,757</u>	<u>8,397,792</u>
Total long-term liabilities	<u>440,391,650</u>	<u>402,569,325</u>
Total liabilities	<u>537,945,800</u>	<u>460,722,245</u>
COMMITMENTS AND CONTINGENCIES (Notes 8, 10, 11 and 12)		
<b>NET POSITION</b>		
Net investment in capital assets	80,544,811	71,527,793
Restricted for debt service	167,081	407,989
Restricted—other (Note 2)	4,675,000	-
Unrestricted	<u>(12,308,700)</u>	<u>80,279,909</u>
TOTAL NET POSITION	<u>\$ 73,078,192</u>	<u>\$ 152,215,691</u>

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, 2017 AND 2016**

	2017	2016
OPERATING REVENUES:		
Hotel revenues	\$ 85,212,181	\$ 91,282,156
Venue revenues	21,894,656	17,322,227
Parking revenues	11,112,728	8,280,885
Other operating revenues	<u>3,164,259</u>	<u>3,107,604</u>
Total operating revenues	<u>121,383,824</u>	<u>119,992,872</u>
OPERATING EXPENSES:		
Hotel expenses	34,737,078	39,011,230
Venue expenses	31,071,598	30,436,248
Parking expenses	8,697,558	9,573,253
Visit Houston expenses	25,585,747	24,482,295
General and administrative expenses	42,545,839	42,356,188
Enterprise development expenses	4,145,342	4,009,565
Hurricane Harvey costs	60,289,168	-
Depreciation and amortization	<u>16,254,144</u>	<u>11,585,818</u>
Total operating costs and expenses	<u>223,326,474</u>	<u>161,454,597</u>
OPERATING LOSS	<u>(101,942,650)</u>	<u>(41,461,725)</u>
NONOPERATING REVENUES (EXPENSES):		
Transfers from primary government	67,132,522	72,152,657
Sponsorship expense	(16,685,953)	(7,834,968)
Transfers to primary government	(17,584,302)	(18,064,748)
Interest expense	(9,036,968)	(8,512,175)
Interest income	452,502	527,872
Loss on capital assets disposal	<u>(1,472,650)</u>	<u>-</u>
Total nonoperating revenues	<u>22,805,151</u>	<u>38,268,638</u>
DECREASE IN NET POSITION	(79,137,499)	(3,193,087)
NET POSITION—Beginning of year	<u>\$ 152,215,691</u>	<u>\$ 155,408,778</u>
NET POSITION—End of year	<u>\$ 73,078,192</u>	<u>\$ 152,215,691</u>

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, 2017 AND 2016**

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 130,010,384	\$ 114,799,935
Cash payments to suppliers for goods and services	(93,386,639)	(96,400,242)
Cash payments to employees for services	(57,398,212)	(58,035,118)
Cash transfers from the City per agreements	90,400,645	73,489,427
Cash payments to the City per agreements	(17,584,302)	(18,064,748)
Cash payments for sponsorships	(16,685,953)	(7,834,968)
Cash payments for Hurricane Harvey costs	(42,370,394)	-
Net cash (used in) provided by operating activities	<u>(7,014,471)</u>	<u>7,954,286</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Payments for interest	<u>(5,548,500)</u>	<u>(2,995,372)</u>
Net cash used in non-capital financing activities	<u>(5,548,500)</u>	<u>(2,995,372)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Payments for interest	(5,382,328)	(7,755,916)
Principal payment on note payable	(21,830,000)	(9,160,000)
Proceeds from debt financing	62,240,000	-
Payment for debt issuance costs	(366,336)	-
Payment for deposits held by others	1,899,342	(1,499,967)
Acquisition of property, plant, and equipment	<u>(20,031,161)</u>	<u>(88,008,084)</u>
Net cash provided by (used in) capital and related financing activities	<u>16,529,517</u>	<u>(106,423,967)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received on investments	156,472	251,571
Purchase of investments	(69,503,674)	(19,806,212)
Proceeds from sales and maturities of investments	<u>72,491,528</u>	<u>64,400,704</u>
Net cash provided by investing activities	<u>3,144,326</u>	<u>44,846,063</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,110,872	(56,618,990)
CASH AND CASH EQUIVALENTS—Beginning of year	<u>34,791,924</u>	<u>91,410,914</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 41,902,796</u>	<u>\$ 34,791,924</u>

(Continued)

# HOUSTON FIRST CORPORATION

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

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

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	2017	2016
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	\$ (101,942,650)	\$ (41,461,725)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	16,254,144	11,585,818
Decrease (increase) in accounts receivable—net	8,963,595	(5,929,085)
Increase in prepaid expenses and other assets	(599,104)	(1,577,609)
Increase in other assets	(625,637)	(4,240,704)
(Decrease) increase in accounts payable	(3,182,563)	816,652
Increase in accrued expenses	405,615	1,518,263
Increase in due to primary government	22,994,591	1,881,439
Increase in accounts payable related to Hurricane Harvey costs	17,918,775	-
Nonoperating income (expenses):		
Transfers from City	67,132,522	72,152,657
Other City obligations	(17,310,771)	(18,609,417)
Sponsorship expense	(16,685,953)	(7,834,968)
Decrease in deferred revenue	<u>(337,035)</u>	<u>(347,035)</u>
Net cash (used in) provided by operating activities	<u>\$ (7,014,471)</u>	<u>\$ 7,954,286</u>
NONCASH TRANSACTIONS:		
Fair market value adjustment related to investments	<u>\$ (172,008)</u>	<u>\$ 60,190</u>

See notes to the financial statements.

(Concluded)



# HOUSTON FIRST CORPORATION

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

## NOTES TO THE FINANCIAL STATEMENTS

### AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

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#### 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 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, including restricted cash and cash equivalents, as cash and investments that are highly liquid, with less than three-month maturities when purchased. Restricted cash and cash equivalents of \$4,675,000 represents monies expected to be utilized by October 2018 for a tenant allowance. Such amounts are also recorded as other restricted net assets in the 2017 Statement of Net Position.

**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 \$505,785 and \$475,639 at December 31, 2017 and 2016, 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 \$1,000 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. There were no impairment changes recognized by the Corporation during the years ended December 31, 2017 and 2016.

**Depreciation**—Depreciation is provided on a straight-line basis over the estimated useful lives of the depreciable assets, ranging from three to 40 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 \$4,757,058 and \$5,163,294 for the years ended December 31, 2017 and 2016, 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 for the years ended December 31, 2017 and 2016 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 \$67,132,522 and \$72,152,657 for 2017 and 2016, 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, 2017 and 2016, these payments totaled \$17,584,302 and \$18,064,748, 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 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 determined there will be no effect on its financial position, results of operations, or cash flows upon adoption.

In May of 2017, the 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 note 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 determined there will be no effect on its financial position, results of operations, or cash flows upon adoption.

In June of 2017, the GASB issued Statement No. 87, *Leases*. Statement No. 87 requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of Statement No. 87 are effective for reporting periods beginning after December 15, 2019. The Corporation has not yet determined the impact of this pronouncement on its financial position, results of operations, or cash flows upon implementation.

### 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 \$41,902,796 and \$34,791,924 as of December 31, 2017 and 2016, respectively, are maintained in cash, demand accounts, escrow, and money market mutual funds. The accounts that comprise this balance are described below:

	2017	2016
Demand deposit accounts	\$ 26,485,130	\$ 26,405,225
Cash on hand	97,921	126,447
Money market	10,644,745	8,260,252
Restricted cash	<u>4,675,000</u>	<u>-</u>
Total	<u>\$ 41,902,796</u>	<u>\$ 34,791,924</u>

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. The Corporation's restricted cash is held in a third-party managed deposit accounts and is restricted as to its use under one of its leasing agreements (See Note 10).

### 4. EQUITY IN POOLED INVESTMENTS

**Short-term Equity in Pooled Investments**—As of December 31, 2017 and 2016, the Corporation's pooled investments included \$51,308,633 and \$52,913,492, 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 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, 2017 and 2016 totaled \$18,756,244 and \$19,843,207, respectively.

As of December 31, 2017 and 2016, the Corporation's exposure to interest rate risk as measured by the segmented time distribution by investment type is summarized below:

	December 31, 2017 Fair Value	Investment Maturities in Years	
		Less than 1	1–5
City of Houston General Pool	\$ 18,756,244	\$ -	\$ 18,756,244
TexSTAR	<u>51,308,633</u>	<u>51,308,633</u>	<u>-</u>
Total Investment Pools	<u>\$ 70,064,877</u>	<u>\$ 51,308,633</u>	<u>\$ 18,756,244</u>
	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	<u>52,913,492</u>	<u>52,913,492</u>	<u>-</u>
Total Investment Pools	<u>\$ 72,756,699</u>	<u>\$ 52,913,492</u>	<u>\$ 19,843,207</u>

The Corporation's exposure to credit risk at December 31, 2017 and 2016 is presented below by investment category as rated by Standard & Poor's and Fitch:

	December 31, 2017	
	Fair Value	Rating
City of Houston General Pool	\$ 18,756,244	AAA by Fitch
TexSTAR	<u>51,308,633</u>	AAAm by Standard & Poor's
Total Investment Pools	<u>\$ 70,064,877</u>	

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

**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.

The City of Houston general pool investment is a Level 2 investment. 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 is measured at net asset value. Under this method, fixed income securities are valued each day by independent or affiliated commercial pricing services or third party broker-dealers. When 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 then 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, 2017 and 2016, the deposits held by others included in the statements of net position totaled \$5,468,164 and \$7,367,500, 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 \$58,886,102 and \$59,136,162 as of December 31, 2017 and 2016, respectively, with \$250,000 reported in current assets in the consolidated balance sheets.

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

<b>Years Ending</b>	<b>Total</b>
<b>December 31</b>	<b>Payments</b>
2018	\$ 250,000
2019	250,000
2020	250,000
2021	250,000
2022	250,000
2023-2027	1,500,000
2028-2032	2,500,000
2033-2037	5,000,000
2038-2042	7,500,000
2043-2047	7,500,000
2048-2052	8,500,000
2053-2057	10,000,000
2058-2062	10,000,000
2063-2065	5,136,102
Total	<u>\$ 58,886,102</u>



## 7. PROPERTY, PLANT, AND EQUIPMENT—NET

The changes in the Corporation's property, plant, and equipment for the years ended December 31, 2017 and 2016, were as follows:

	January 1, 2017	Additions/ Transfers	Retirements/ Transfers	December 31, 2017
Property, plant, and equipment, not subject to depreciation:				
Land	\$ 14,824,298	\$ -	\$ -	\$ 14,824,298
Construction in progress	<u>81,965,952</u>	<u>14,111,579</u>	<u>(80,187,367)</u>	<u>15,890,164</u>
Total property, plant, and equipment, not subject to depreciation	<u>96,790,250</u>	<u>14,111,579</u>	<u>(80,187,367)</u>	<u>30,714,462</u>
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	378,009,011	83,941,586	(1,057,920)	460,892,677
Furnishings and equipment	<u>45,775,479</u>	<u>3,265,532</u>	<u>(1,177,028)</u>	<u>47,863,983</u>
Total property, plant, and equipment, subject to depreciation	<u>423,784,490</u>	<u>87,207,118</u>	<u>(2,234,948)</u>	<u>508,756,660</u>
Less accumulated depreciation for:				
Hotel and garage buildings	(88,274,403)	(13,283,597)	148,446	(101,409,554)
Furnishings and equipment	<u>(34,505,499)</u>	<u>(2,970,547)</u>	<u>608,988</u>	<u>(36,867,058)</u>
Total accumulated depreciation	<u>(122,779,902)</u>	<u>(16,254,144)</u>	<u>757,434</u>	<u>(138,276,612)</u>
Total property, plant, and equipment—net	<u>\$ 397,794,838</u>	<u>\$ 85,064,553</u>	<u>\$ (81,664,881)</u>	<u>\$ 401,194,510</u>
	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	<u>108,637,141</u>	<u>82,507,940</u>	<u>(109,179,131)</u>	<u>81,965,950</u>
Total property, plant, and equipment, not subject to depreciation	<u>123,461,439</u>	<u>82,507,940</u>	<u>(109,179,131)</u>	<u>96,790,248</u>
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	274,028,965	103,980,047	-	378,009,012
Furnishings and equipment	<u>41,072,166</u>	<u>4,703,314</u>	<u>-</u>	<u>45,775,480</u>
Total property, plant, and equipment, subject to depreciation	<u>315,101,131</u>	<u>108,683,361</u>	<u>-</u>	<u>423,784,492</u>
Less accumulated depreciation for:				
Hotel and garage buildings	(79,578,653)	(8,695,750)	-	(88,274,403)
Furnishings and equipment	<u>(31,615,430)</u>	<u>(2,890,068)</u>	<u>-</u>	<u>(34,505,498)</u>
Total accumulated depreciation	<u>(111,194,083)</u>	<u>(11,585,818)</u>	<u>-</u>	<u>(122,779,901)</u>
Total property, plant, and equipment—net	<u>\$ 327,368,487</u>	<u>\$ 179,605,483</u>	<u>\$ (109,179,131)</u>	<u>\$ 397,794,838</u>

The decrease in construction in progress costs in 2017 is a result of the Convention District projects being completed and placed in service in 2017.

## 8. NOTES PAYABLE

The Corporation's notes payable and related premium for the years ended December 31, 2017 and 2016 were as follows:

	January 1, 2017	Retirements/ Amortization	Additions	December 31, 2017
Notes payable				
Notes payable—City of Houston	\$ 262,210,000	\$ (21,830,000)	\$ 62,240,000	\$ 302,620,000
Premium—net of discount	<u>19,161,811</u>	<u>(2,193,258)</u>	<u>-</u>	<u>16,968,553</u>
Total notes payable COH	281,371,811	(24,023,258)	62,240,000	319,588,553
Note payable—VALIC	<u>125,000,000</u>	<u>-</u>	<u>-</u>	<u>125,000,000</u>
Total notes payable	<u>\$ 406,371,811</u>	<u>\$ (24,023,258)</u>	<u>\$ 62,240,000</u>	<u>\$ 444,588,553</u>
	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	<u>20,769,403</u>	<u>(1,607,592)</u>	<u>-</u>	<u>19,161,811</u>
Total notes payable COH	292,139,403	(10,767,592)	-	281,371,811
Note payable—VALIC	<u>125,000,000</u>	<u>-</u>	<u>-</u>	<u>125,000,000</u>
Total notes payable	<u>\$ 417,139,403</u>	<u>\$ (10,767,592)</u>	<u>\$ -</u>	<u>\$ 406,371,811</u>

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:

December 31	Principal	Interest	Total
2018	10,400,000	16,270,319	26,670,319
2019	10,930,000	15,964,919	26,894,919
2020	136,345,000	11,904,802	148,249,802
2021	12,160,000	9,686,224	21,846,224
2022	12,320,000	9,287,237	21,607,237
2023-2027	118,665,000	36,643,691	155,308,691
2028-2032	78,815,000	20,574,508	99,389,508
2033-2037	31,115,000	7,468,925	38,583,925
2038-2042	13,020,000	2,250,400	15,270,400
2043-2045	<u>3,850,000</u>	<u>232,600</u>	<u>4,082,600</u>
Total	<u>\$ 427,620,000</u>	<u>\$ 130,283,625</u>	<u>\$ 557,903,625</u>

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 HOT 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 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 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 HOT 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.

On November 16, 2017, the City issued \$12,030,000 of Convention & Entertainment Facilities Department HOT and Special Revenue Refunding Bonds, Series 2017. This issue has a stated interest rates of 2.55% maturing in 2033. Proceeds were used to refund the City's outstanding Convention & Entertainment Facilities Department HOT and Special Revenue Refunding Bonds, Series 2011B. Net present value savings totaled \$1.9 million or 16.5% of the refunded bonds.

On November 16, 2017, the City issued \$75,000,000 of Convention & Entertainment Facilities Subordinate Lien HOT and Parking Revenue Flexible Rate Notes, Series A. As of December 31, 2017, the City drew down \$50,000,000 of the notes. The taxable variable

rate is equal to 100% LIBOR+1.08%. The tax exempt variable rate is equal to 65.01% LIBOR+0.69%. The commitment fee is equal to 0.20%.

Of the total \$302,620,000 notes payable to City of Houston, \$177,410,000 of the principal balance relates to the City's fixed-rate bonds and carries interest rates ranging from 1.5% to 5.25%; \$50,210,000 related to the flexible rate notes and 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, 2017 and 2016 was approximately 1.56% and 0.85%, respectively. Fees on the variable-rate bonds are 0.07% per year for 2017 and 2016. 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, 2017 and 2016, on the variable-rate bonds, plus expenses, for a total variable rate of 1.63% and 0.92%, respectively.

## 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 5<sup>th</sup> of the year following opening of the hotel facility. See Note 6 above.

**Lease 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 \$42,072,388, accumulated depreciation of \$1,102,582, and a carrying value of \$41,025,126. 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 \$87,837,344, and a carrying value of \$155,853,343. The sub-lease agreements relate to assets that are leased from the City of Houston and are 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, 2017 is as follows:

<u>Year Ending</u> <u>December 31</u>	<u>Operating</u> <u>Leases</u>
2018	\$ 2,615,725
2019	2,639,973
2020	2,690,333
2021	2,707,789
2022	2,750,956
Thereafter	23,209,292

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, 2017 and 2016, the unamortized balance of rent

concessions included in Other Assets-Net was \$5,950,194 and \$4,684,694, respectively. For the years ended December 31, 2017 and 2016, the amortization expense included in Venue revenues was \$104,918 and \$291,583, respectively. 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 \$154,722 and \$156,811 for the years ended December 31, 2017 and 2016, respectively.

**Hurricane Harvey**—Under the Consolidation Interlocal Agreement, the Corporation is responsible for rebuilding and repairing the leased facilities in the event of a damage from casualty. As such, the Corporation selected a project manager in December of 2017, a designer, and a construction manager at risk in the first quarter of 2018 to fulfill this commitment. The remaining costs to complete the restoration of the affected facilities is estimated to total \$86,712,000 and the majority of these costs are subject to reimbursement from the Federal Emergency Management Agency (FEMA).

## 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.

The agreements with Embassy Suites and Hampton Inn-Homewood Suite require that 100% of their Hotel Occupancy Tax paid will be paid back to them. Both hotels have agreed to provide HFC with room-blocks for various events in exchange for these agreements. The agreement with Embassy Suites expired on January 1, 2018 and was not renewed. The agreement with Hampton Inn-Homewood Suite is valid until April 1, 2022.

The agreements with JW Marriott, Aloft Houston Downtown, LeMeridien and Alessandra state that 50% of their Hotel Occupancy Tax paid will be paid back to them. The agreements with JW Marriot, Aloft Houston Downtown, LeMeridien and Alessandra will expire on September 1, 2021, December 1, 2023, October 1, 2032, and October 1, 2024,

respectively. All hotels have 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, 2017 and 2016. No payments were made to LeMeridien and Alessandra in 2017 and 2016.

	2017	2016
Embassy Suites	\$ 839,916	\$ 915,788
JW Marriott	740,277	666,828
Hampton Inn - Homewood Suites	435,547	-
Aloft Houston	<u>34,106</u>	<u>-</u>
Total	<u>\$ 2,049,846</u>	<u>\$ 1,582,616</u>

### 13. HURRICANE HARVEY

During the third quarter of 2017, several properties managed by the Corporation on the City's behalf experienced flood-related damage as a result of Hurricane Harvey and its aftermath. The Corporation carries comprehensive property, casualty, flood, and business interruption insurance through the City. The Corporation recognized losses of approximately \$1.5 million to write-off the net book value of damaged assets as of December 31, 2017 and incurred approximately \$60 million of non-capital and \$7 million of capital restoration costs during the year ended December 31, 2017. As of December 31, 2017, the Corporation has not received any insurance proceeds for the damages. Insurance proceeds received will be reflected as revenue in the period such proceeds are received.

The following list reflects the properties damaged as a result of Hurricane Harvey:

- Theater District Garages - located in downtown Houston, Texas
- Wortham Theater - located in downtown Houston, Texas
- Jones Hall - located in downtown Houston, Texas

The Theater District Garages and Jones Hall were temporarily closed but reopened in November 2017. Wortham Theater was closed and plans on reopening September 2018.

### 14. SUBSEQUENT EVENTS

On May 22, 2018, the Corporation received a \$10 million advance on insurance proceeds as a result of damages caused by Hurricane Harvey. This advance is subject to a FEMA determination of the allocation of the total insurance proceeds to all departments and component units of the City.

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