

Houston First Corporation

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

Financial Statements as of and for the Years
Ended December 31, 2012 and 2011, and
Independent Auditors' Report

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

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1-2
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)	3-9
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011:	
Statements of Net Position	10
Statements of Revenues, Expenses, and Changes in Net Position	11
Statements of Cash Flows	12
Notes to Financial Statements	13-25

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Houston First Corporation (the "Corporation"), which comprise the statement of net position, as of December 31, 2012 and 2011, 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 financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on the 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 that audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material aspects, the net position of Houston First Corporation as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion on Supplementary Information — Management's Discussion and Analysis

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information — Management's Discussion and Analysis, listed in the table of contents on Pages 3–9 is presented for the purpose of additional analysis and is not a required part of the financial statements. This supplementary information is the responsibility of the Corporation's management. Such information has not been subjected to the auditing procedures applied in our audits of the financial statements and, accordingly it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Deloitte & Touche LLP

June 19, 2013

HOUSTON FIRST CORPORATION

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

AS OF DECEMBER 31, 2012 AND 2011

The following discussion of the 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, Parking Garage, and Convention Center (the "Project"). Construction was completed and the Project opened for business in December 2003 as Hilton Americas — Houston. As of December 31, 2012 and 2011, Hilton Management LLC managed the Hotel through a qualified management contract (the "Management Agreement"), and Ace Parking Management managed the Parking Garage. For the years ended December 31, 2012 and 2011, interest earned from investments, net revenues from the operations of the Project, plus certain tax rebates collected at and remitted from operations located within the Project were sufficient to fund expenses of the Corporation, pay the monthly debt service expense, and fund the remaining obligations between the Hotel Corporation and the City.

On June 1, 2011, the City of Houston City Council approved the consolidation of the Convention & Entertainment Facilities Department of the City ("Department") into the Hotel Corporation ("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," 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, composed of the same members of the board that made up the Hotel Corporation's board of directors, as it existed at the time of the Consolidation.

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 ("Consolidation Interlocal Agreement") with the Corporation, 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 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.

OVERVIEW OF THE FINANCIAL STATEMENTS

The statements of net position present information on all of the Corporation's assets, deferred outflow 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 10 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 11 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 page 12 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 13–26 of this report.

NET POSITION

Total net position at December 31, 2012, was \$62,128,802, a 99.2% increase from December 31, 2011. Total net position at December 31, 2011, was \$31,185,359, a 1,109.8% increase from December 31, 2010.

CONDENSED STATEMENTS OF NET POSITION
DECEMBER 31, 2012, 2011, AND 2010

	December 31, 2012	December 31, 2011	December 31, 2010
	<u> </u>	<u> </u>	<u> </u>
Current assets	\$ 100,932,626	\$ 81,583,669	\$ 44,540,552
Noncurrent assets	43,336,921	39,056,583	20,042,272
Capital assets	221,444,817	222,658,969	216,468,831
Total assets	<u>\$ 365,714,364</u>	<u>\$ 343,299,221</u>	<u>\$ 281,051,655</u>
Deferred Outflow of Resources	<u>\$ 1,661,106</u>	<u>\$ 406,397</u>	<u>\$ -</u>
Current liabilities	\$ 48,321,447	\$ 47,619,133	\$ 22,933,006
Long-term liabilities	256,925,221	264,901,126	262,344,607
Total liabilities	<u>\$ 305,246,668</u>	<u>\$ 312,520,259</u>	<u>\$ 285,277,613</u>
Net position	<u>\$ 62,128,802</u>	<u>\$ 31,185,359</u>	<u>\$ (4,225,958)</u>

Total assets increased \$22,415,143 to \$365,714,364 at December 31, 2012, from \$343,299,221 at December 31, 2011. Of this increase, \$18,842,542 is in short-term equity in pooled investments and \$2,281,266 in cash and cash equivalents, and it is attributable to working capital and reserve transfers authorized in the Consolidation, HOT funds held as agent for the City, and cash generated from operations.

In May 2001, the City issued Hotel Occupancy Tax and Special Revenue Bonds, Series 2001 A and B and Hotel Occupancy Tax Special Revenue Adjustable Rate Bonds, Series 2001 C (the "Bonds"), which provided the permanent funding for the payment of the total cost of the Project incurred by the Corporation. Proceeds of the Bonds allocated for the Project were loaned by the City to the Corporation and evidenced by a note payable. As of year-end, amounts held in the debt service reserve funds were the only remaining unspent proceeds from these Bonds.

On August 31, 2011, the City issued Hotel Occupancy Tax and Special Revenue Refunding Bonds, Series 2011A and 2011B. The true interest cost of the issue was 4.26%. The bonds mature in varying amounts from 2012 to 2033. Net present value savings totaled \$9.4 million or 3.92% of the refunded bonds. The Series 2011B Bonds were hotel-allocated bonds, and proceeds were used to refund the hotel-allocated portions 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-rate debt, and to fund an additional deposit to the debt service reserve fund. As of December 31, 2012 and 2011, the amount of the note that is amortized based on City-issued variable-rate debt was \$75 million and \$75 million, respectively, with the remainder based on City-issued fixed-rate debt. The variable-rate debt has been issued as seven-day auction rate securities with 10% being the maximum interest rate permitted.

On August 15, 2012, the City issued \$41,525,000 of Convention & Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2012 with 5% coupons. The true interest cost was 4.80%. The bonds mature in varying amounts from 2026 to 2033. Proceeds were used to refund \$41,245,000 of the 2001B2 Convention & Entertainment HOT and Special Revenue Refunding Bonds. Net present value savings totaled \$1.9 million or 4.67% of the refunded bonds and reduced total debt service by \$2.3 million.

Funds held by the City, listed as equity in pooled investments — restricted, include the debt service reserve funds, the debt service funds, and tax rebates and are invested in the City's General Investment Pool. The amount of the investments held by the City was \$35,027,021 and \$35,464,259 at December 31, 2012 and 2011, respectively.

The Corporation made principal payments totaling \$12,720,000 and \$10,415,000 in 2012 and 2011, respectively. The total notes payable balance includes the Corporation's allocable portion of the unamortized bond premiums, net of discounts, which totaled \$5,467,631 and \$4,348,251 at December 31, 2012 and 2011, respectively. The net amortization on the premiums and discounts totaled \$1,424,790 and \$676,756 for the years ended December 31, 2012 and 2011, respectively. Accumulated amortization of the bond premiums, net of discounts, totaled \$1,939,963 and \$138,795 at December 31, 2012 and 2011, 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. The Corporation did not borrow additional amounts from the City during 2012 or 2011.

Total liabilities decreased \$7,273,591 to \$305,246,668 in 2012 from \$312,520,259 in 2011, which was primarily attributable to the principal payments of debt.

For 2011, the Corporation's change in net position not only eliminated the 2010 deficit of \$4,225,959, but moved to a positive net position of \$31,185,359. This change, which represents a difference of \$35,441,318, was primarily attributable to the assignment and transfer of net available pledged revenues from the Department to the Corporation authorized in the Consolidation Interlocal Agreement. For 2011, the net available pledged revenues transfer totaled \$53,169,726.

The Corporation's net position increased \$30,943,443 to \$62,128,802 at December 31, 2012, from \$31,185,359 at December 31, 2011. Of this increase, \$22,415,143 is attributable to an increase in assets and \$7,975,905 is attributable to a decrease in long-term debt as described on the previous page.

CONDENSED STATEMENTS OF CHANGES IN NET POSITION

DECEMBER 31, 2012, 2011, AND 2010

	December 31, 2012	December 31, 2011	December 31, 2010
OPERATING REVENUES:			
Hotel revenues	\$ 82,296,639	\$ 71,124,882	\$ 69,657,922
Venue revenues	16,711,814	4,745,362	-
Parking revenues	4,704,900	4,147,261	3,725,121
Other operating revenues	3,552,799	3,623,772	3,968,301
	<hr/>	<hr/>	<hr/>
Total operating revenues	107,266,152	83,641,277	77,351,344
OPERATING COSTS AND EXPENSES:			
Hotel expenses:			
Direct expenses	28,781,196	25,875,289	28,869,461
Management fees	3,525,818	3,149,669	2,509,730
Depreciation	8,990,539	7,835,057	7,815,687
General and administrative	22,284,187	20,046,557	20,246,542
Lease expense	1,650,215	1,419,675	-
Other hotel expenses	3,678,566	3,648,009	-
Parking expenses	2,107,454	1,134,313	-
Venue expenses:			
Depreciation and amortization	215,000	-	-
Direct expenses	28,985,037	14,720,043	-
General and administrative	8,945,209	4,034,341	-
	<hr/>	<hr/>	<hr/>
Total operating costs and expenses	109,163,221	81,862,953	59,441,420
OPERATING INCOME (LOSS)	<hr/> (1,897,069)	<hr/> 1,778,324	<hr/> 17,909,924
NONOPERATING REVENUES (EXPENSES):			
Allocation of garage income to the City of Houston	-	(664,104)	(675,662)
Other income	110,668	657,622	1,050
Tax rebates	9,799,524	8,651,773	8,208,410
Transfers from primary government	64,266,743	53,169,726	-
GHCVB contract expense	(15,610,063)	(7,241,886)	-
Sponsorship expense	(3,091,807)	(1,458,707)	-
Transfers to primary government	(14,769,257)	(10,623,736)	(15,095,925)
Interest expense	(8,368,772)	(9,132,172)	(8,897,903)
Interest income	503,476	274,477	657,151
	<hr/>	<hr/>	<hr/>
Total nonoperating revenues (expenses)	32,840,512	33,632,993	(15,802,879)
CHANGE IN NET POSITION	30,943,443	35,411,317	2,107,045
NET POSITION — Beginning of year, as restated	<hr/> 31,185,359	<hr/> (4,225,958)	<hr/> (6,333,003)
NET POSITION — End of year	<hr/> \$ 62,128,802	<hr/> \$ 31,185,359	<hr/> \$ (4,225,958)

1. Operating Revenues

Total operating revenues for 2012 and 2011 were \$107,266,152 and \$83,641,277, respectively. The increase in operating revenues was primarily (51%) attributable to the recognition of a full year of revenue versus six months of revenue from the leased venues as a result of the Consolidation, with the remaining increase due to an increase in rooms' revenue at the Hotel.

2. Tax Rebates

Tax rebates increased \$1,147,751 from \$8,651,773 in 2011 to \$9,799,524 in 2012. The increase was primarily due to strong growth in HOT, which was directly related to the increase in rooms' revenue.

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. For 2012, the amount transferred from the Department was \$64,266,743 and represents the HOT revenues remaining after debt service and other debt-related expenses were paid, the remaining initial working capital transfer, and the transfer of other remaining Department fund balances.

4. Operating Costs and Expenses

In 2011 and 2012, direct expenses were related to hotel, parking, and leased venue operations. Total direct expenses increased \$18,405,139 from \$46,797,329 in 2011 to \$65,202,468 in 2012. Approximately, 77% of the net increase was attributable to a full year of leased venue direct expenses in 2012 versus six months in 2011. The remaining increase in direct expenses was realized through hotel operations, includes the \$1,380,000 annual lease payment to the City, and was proportionate to the increase in hotel operating revenues. Direct operating expenses related to hotel operations as a percentage of hotel operating revenues was 35% and 37% in 2012 and 2011, respectively.

Management fees increased \$376,149 from \$3,149,669 in 2011 to \$3,525,818 in 2012 based on the formula provided in the management fee rider of the Management Agreement.

The Corporation's operating income before depreciation totaled \$7,308,470 and \$9,613,381 in 2012 and 2011, respectively. The Corporation's depreciation expense for 2012 and 2011 totaled \$9,205,539 and \$7,835,057, respectively.

The Corporation's operating income (loss), which includes the noncash charge of depreciation totaled \$(1,897,069) and \$1,778,324 in 2012 and 2011, respectively.

5. General and Administrative Expenses

In 2011 and 2012, general and administrative expenses were incurred from both hotel and leased venue operations. General and administrative expenses increased \$7,148,498 to \$31,229,396 in 2012 from \$24,080,898 in 2011. The increase was attributable to the recognition of a full year of revenue versus six months of revenue from the leased venues as a result of the Consolidation.

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, 2012, those payments totaled \$14,769,257. At December 31, 2011, payments of \$10,623,736 were made by the Hotel Corporation to the City.

7. Interest Expense

Interest expense decreased \$763,400 from \$9,132,172 in 2011 to \$8,368,772 in 2012. The decrease in interest expense was primarily due to lower variable interest rates on the note payable to the City in 2012.

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

GHCVB contract expense increased \$8,368,177 from \$7,241,886 in 2011 to \$15,610,063 in 2012. The increase was attributable to payments for 12 months in 2012 versus six months in 2011 as a result of Consolidation.

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

STATEMENTS OF NET POSITION
DECEMBER 31, 2012 AND 2011

	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 51,992,515	\$ 49,711,249
Accounts receivable — net	3,903,477	5,857,110
Tax rebates receivable	1,868,712	1,810,664
Inventories	136,133	189,554
Prepaid expenses and other current assets	1,210,855	1,036,700
Short-term equity in pooled investments	<u>41,820,934</u>	<u>22,978,392</u>
Total current assets	100,932,626	81,583,669
EQUITY IN POOLED INVESTMENTS — Restricted	35,027,021	35,464,259
PROPERTY, PLANT, AND EQUIPMENT — Net	221,444,817	222,658,969
OTHER ASSETS — Net	<u>8,309,900</u>	<u>3,592,324</u>
TOTAL ASSETS	<u>365,714,364</u>	<u>343,299,221</u>
DEFERRED OUTFLOW OF RESOURCES — Deferred amounts from refunding of debt	<u>1,661,106</u>	<u>406,397</u>
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	12,522,990	9,386,916
Accrued interest	2,931,293	2,943,668
Accrued expenses	9,658,077	8,038,949
Due to City of Houston	12,297,052	13,692,565
Current portion of note payable	9,875,000	12,720,000
Current portion of unearned revenue	637,035	437,035
Current portion of inducement fee from Hotel Operator	<u>400,000</u>	<u>400,000</u>
Total current liabilities	<u>48,321,447</u>	<u>47,619,133</u>
LONG-TERM LIABILITIES:		
Note payable	237,122,632	245,598,252
Unearned revenue	9,745,931	10,082,966
Inducement fee from Hotel Operator	1,966,667	2,366,667
Subordinated management fee	<u>8,089,991</u>	<u>6,853,241</u>
Total long-term liabilities	<u>256,925,221</u>	<u>264,901,126</u>
Total liabilities	<u>305,246,668</u>	<u>312,520,259</u>
COMMITMENTS AND CONTINGENCIES (Note 10)		
NET POSITION		
Net investment in capital assets	(6,746,203)	(19,974,577)
Restricted for debt service	15,157,828	18,776,516
Unrestricted	<u>53,717,177</u>	<u>32,383,420</u>
TOTAL NET POSITION	<u>\$ 62,128,802</u>	<u>\$ 31,185,359</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, 2012 AND 2011

	2012	2011
OPERATING REVENUES:		
Hotel revenues	\$ 82,296,639	\$ 71,124,882
Venue revenues	16,711,814	4,745,362
Parking revenues	4,704,900	4,147,261
Other operating revenues	<u>3,552,799</u>	<u>3,623,772</u>
Total operating revenues	<u>107,266,152</u>	<u>83,641,277</u>
OPERATING COSTS AND EXPENSES:		
Hotel expenses:		
Direct expenses	28,781,196	25,875,289
Management fees	3,525,818	3,149,669
Depreciation and amortization	8,990,539	7,835,057
General and administrative	22,284,187	20,046,557
Lease expense	1,650,215	1,419,675
Other hotel expenses	3,678,566	3,648,009
Parking expenses	2,107,454	1,134,313
Venue expenses:		
Direct expenses	28,985,037	14,720,043
Depreciation and amortization	215,000	-
General and administrative	<u>8,945,209</u>	<u>4,034,341</u>
Total operating costs and expenses	<u>109,163,221</u>	<u>81,862,953</u>
OPERATING (LOSS) INCOME	<u>(1,897,069)</u>	<u>1,778,324</u>
NONOPERATING REVENUES (EXPENSES):		
Allocation of garage income to the City	-	(664,104)
Other income	110,668	657,622
Tax rebates	9,799,524	8,651,773
Transfers from primary government	64,266,743	53,169,726
GHCVB contract expense	(15,610,063)	(7,241,886)
Sponsorship expense	(3,091,807)	(1,458,707)
Transfers to primary government	(14,769,257)	(10,623,736)
Interest expense	(8,368,772)	(9,132,172)
Interest income	<u>503,476</u>	<u>274,477</u>
Total nonoperating revenues (expenses)	<u>32,840,512</u>	<u>33,632,993</u>
INCREASE IN NET POSITION	<u>30,943,443</u>	<u>35,411,317</u>
NET POSITION — Beginning of year	32,505,137	(3,567,962)
Effect of restatement (Note 12)	<u>(1,319,778)</u>	<u>(657,996)</u>
NET POSITION — Beginning of year, as restated	<u>31,185,359</u>	<u>(4,225,958)</u>
NET POSITION — End of year	<u>\$ 62,128,802</u>	<u>\$ 31,185,359</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, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 109,847,731	\$ 80,757,315
Cash payments to suppliers for goods and services	(57,568,209)	(43,523,378)
Cash payments to employees for services	(37,987,794)	(30,153,161)
Cash transfers from the City per agreements	62,871,229	66,862,291
Cash payments to the City per agreements	(21,089,593)	(3,629,621)
Cash payments to GHCVB	(15,244,710)	(3,816,917)
Cash payments for sponsorships	<u>(3,091,807)</u>	<u>(1,458,707)</u>
Net cash provided by operating activities	<u>37,736,847</u>	<u>65,037,822</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Payments for interest	(9,295,097)	(8,271,610)
Receipt of tax rebates	10,667,045	8,708,656
Principal payment on note payable	(12,720,000)	(10,415,000)
Proceeds from refunding	1,527,600	14,212,346
Payment for bond issuance costs from refunding	(468,979)	(601,853)
Payment of arbitrage expenses	-	(259,244)
Payment of garage income to the City	-	(615,549)
Distributions to the City	-	(4,008,849)
Acquisition of property, plant, and equipment	<u>(7,264,323)</u>	<u>(13,899,069)</u>
Net cash used in capital and related financing activities	<u>(17,553,754)</u>	<u>(15,150,172)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received on investments	503,476	274,477
Purchase of investments	(62,220,231)	(53,263,102)
Proceeds from sales and maturities of investments	<u>43,814,928</u>	<u>45,747,725</u>
Net cash used in investing activities	<u>(17,901,827)</u>	<u>(7,240,900)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,281,266	42,646,750
CASH AND CASH EQUIVALENTS — Beginning of year	<u>49,711,249</u>	<u>7,064,499</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 51,992,515</u>	<u>\$ 49,711,249</u>
NONCASH TRANSACTIONS — Capital additions included in liabilities	<u>\$ 727,064</u>	<u>\$ 126,127</u>

See notes to the financial statements

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, 2012 AND 2011

1. ORGANIZATION

The 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 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 "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 of Houston City Council ("City Council") approved the consolidation of the City's Convention & Entertainment Facilities Department ("Department") into the Hotel Corporation ("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, composed of the same members of the board that made up the Hotel Corporation's board of directors, as it existed at the time of the Consolidation.

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 ("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.

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 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 \$10,706 and \$29,988 at December 31, 2012 and 2011, respectively.

Inventories — Inventories consist principally of food and beverage and are stated at the lower of cost (as determined on a first-in, first-out basis) or market value. Supplies are expensed when placed in service.

Tax Rebates — Mixed beverage, hotel occupancy, and sales taxes are currently collected in the normal course of hotel operations and subsequently remitted to the local and state taxing authorities. As a result of tax rebate agreements with the City; Metropolitan Transit Authority of Harris County, Texas (“Metro”); Harris County, Texas; and the state of Texas, all of the taxes collected, with the exception of Harris County Houston Sports Authority’s 2% HOT and the state of Texas mixed beverage tax, are rebated to the Corporation, and have been pledged to the City’s Hotel Occupancy Tax and Special Revenue Bonds, Series 2001 and the City’s Hotel Occupancy Tax and Special Revenue Refunding Bonds Series 2011 and Series 2012. These rebate agreements are effective until December 2013.

Tax rebates received from these taxing authorities are forwarded to the City and invested in the City’s General Investment Pool until such funds are applied against future principal and interest payments due to the City from the Corporation. Tax rebates included in equity in pooled investments held by the City totaled \$615,246 and \$1,384,047 as of December 31, 2012 and 2011, 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.

Property, Plant, and Equipment — Property, plant, and equipment are recorded at original cost for items purchased. 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. No impairment loss was recognized by the Corporation during the years ended December 31, 2012 and 2011.

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

Debt Issuance Costs/Note 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 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, 2012 and 2011, totaled \$337,035 for each year, 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.

Advertising Expense — Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2012 and 2011, amounted to \$493,716 and \$112,716, respectively, which is included in general and administrative expenses.

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 balance sheet 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.

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, and they are shown as "Transfers from primary government." The amount transferred from the Department was \$64,266,743 and \$53,169,726 for 2012 and 2011, respectively, and represents the HOT revenues remaining after debt service, and other debt-related expenses were paid. Also included in this amount is a transfer from the City of \$5,189,523 and \$11,000,000 for 2012 and 2011, respectively, for initial working capital.

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, 2012, those payments totaled \$14,769,257. At December 31, 2011, payments of \$10,623,736 were made by the Corporation to the City.

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 financial statements include amounts that are based on management's best estimates and judgments. Actual results could differ from those estimates.

Reclassifications — Certain reclassifications to December 31, 2011 financial statement line items have been made to conform to the December 31, 2012 presentation.

New Accounting Pronouncements — In November 2010, the GASB issued GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. The requirements of this statement were effective for financial statements for periods beginning after December 15, 2011. The Corporation has determined there was no effect upon its financial position, results of operations, or cash flows.

In November 2010, the GASB issued GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*. This statement is to improve financial reporting for a governmental financial reporting entity. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2012. The Corporation has not determined the impact, if any, upon its financial position, results of operations, or cash flows upon adoption.

In December 2010, the GASB issued GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in/Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: Financial Accounting Standards Board's statements and interpretation; Accounting Principles Board Opinions; and Accounting Research Bulletins of the American Institute of Certified Public Accountants Committee on Accounting Procedure. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The Corporation has implemented GASB Statement No. 62 in this annual report.

In June 2011, the GASB issued GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement is intended to improve financial reporting by providing citizens and other users of state and local government financial reports with information about how past transactions will continue to affect a government's financial statements in the future. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The Corporation implemented this statement in 2012 and restated the statement of 2011 accordingly (see Note 12).

In June 2011, the GASB issued GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*. This statement will improve financial reporting by state and local governments by clarifying the circumstances in which

hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2011. The Corporation has determined there is no effect upon its financial position, results of operations, or cash flows.

In March 2012, the GASB issued GASB Statement No. 65 *Reporting Items Previously Recognized as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. The Corporation implemented this statement in 2012 and restated the statement of 2011 accordingly (see Note 12).

In March 2012, the GASB issued GASB Statement No. 66, *Technical Corrections — 2012 — an amendment of GASB Statements No. 10 and No. 62*. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, GASB Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. The Corporation has not determined the impact, if any, upon its financial position, results of operations, or cash flows upon adoption.

In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans — an amendment of GASB Statement No. 25*. The objective of this statement is to improve financial reporting by state and local governmental pension plans. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This statement replaces the requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this statement and to defined contribution plans that provide postemployment benefits other than pensions. This statement is effective for financial statements for fiscal years beginning after June 15, 2013. The Corporation has determined there will be no effect upon its financial position, results of operations, or cash flows upon adoption.

In June 2012, the GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27*. The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The Corporation has determined there will be no effect upon its financial position, results of operations, or cash flows upon adoption.

In January 2013, the GASB issued GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The requirements of this statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. The Corporation has not determined the impact, if any, upon its financial position, results of operations, or cash flows upon adoption.

In April 2013, the GASB issued GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. The provisions of this statement are effective for reporting periods beginning after June 15, 2013. The Corporation has not determined the impact, if any, upon its financial position, results of operations, or cash flows upon adoption.

3. RECONCILIATION OF OPERATING PROFIT (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	2012	2011
Operating (loss) profit	\$ (1,897,069)	\$ 1,778,324
Adjustments to reconcile operating (loss) profit to net cash provided by operating activities:		
Depreciation and amortization	9,205,539	7,835,057
Amortization of Hotel Operator fee	(400,000)	(400,000)
Increase in subordinated management fee	-	1,091,881
Decrease (increase) in accounts receivable — net	1,953,633	(3,260,084)
Decrease in inventories	53,421	58,051
Increase in current prepaid expenses	(174,156)	(41,829)
Increase in other assets	(4,717,575)	(3,570,825)
Increase in accounts payable	2,201,827	8,713,113
Increase in accrued expenses	900,742	866,735
(Decrease) increase in due to primary government	(1,395,514)	13,692,565
Increase (decrease) in current portion of unearned revenue	1,099,715	(237,035)
Nonoperating income (expenses):		
Transfers from City	64,266,743	53,169,726
Other City obligations	(14,769,257)	(6,614,887)
GHCVB contract expense	(15,610,063)	(7,241,886)
Sponsorship expense	(3,091,807)	(1,458,707)
Other income	<u>110,668</u>	<u>657,623</u>
Net cash provided by operating activities	<u>\$ 37,736,847</u>	<u>\$ 65,037,822</u>

4. CASH, 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 \$51,992,515 and \$49,711,249 as of December 31, 2012 and 2011, respectively, are maintained in cash, demand accounts, and money market mutual funds. The accounts that comprise this balance are described below:

	2012	2011
Demand deposit accounts	\$ 48,019,298	\$ 48,197,287
Cash on hand	95,900	149,320
Money market	<u>3,877,317</u>	<u>1,364,642</u>
Total	<u>\$ 51,992,515</u>	<u>\$ 49,711,249</u>

The demand deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") per the Dodd Frank Act. 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.

5. EQUITY IN POOLED INVESTMENTS

Short-term Equity in Pooled Investments — As of December 31, 2012 and 2011, the Corporation's pooled investments included \$41,820,934 and \$22,978,392 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 AAAM 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 and 2012, 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. In addition, 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. Also, the Corporation makes monthly payments to the City that provides funding for the semiannual bond payments made by the City. These funds are referred to as the debt service funds. All above-referenced funds are held in the City's Investment Pools. The balance of such accounts at December 31, 2012 and 2011, totaled \$35,027,021 and \$35,464,259, respectively.

At December 31, 2012 and 2011, the Corporation's exposure to interest rate risk as measured by the segmented time distribution by investment type is summarized below:

	December 31, 2012 Fair Value	Investment Maturities in Years	
		Less than 1	1-5
City of Houston General Pool	\$ 35,027,021	\$ -	\$ 35,027,021
TexSTAR	<u>41,820,934</u>	<u>41,820,934</u>	<u>-</u>
Total Investment Pools	<u>\$ 76,847,955</u>	<u>\$ 41,820,934</u>	<u>\$ 35,027,021</u>

	December 31, 2011 Fair Value	Investment Maturities in Years	
		Less than 1	1-5
City of Houston General Pool	\$ 35,464,259	\$ -	\$ 35,464,259
TexSTAR	<u>22,978,392</u>	<u>22,978,392</u>	<u>-</u>
Total Investment Pools	<u>\$ 58,442,651</u>	<u>\$ 22,978,392</u>	<u>\$ 35,464,259</u>

The Corporation's exposure to credit risk at December 31, 2012 and 2011, is presented below by investment category as rated by Standard & Poor's and Fitch:

	December 31, 2012	Rating
	Fair Value	
City of Houston General Pool	\$ 35,027,021	AAA by Fitch
TexSTAR	<u>41,820,934</u>	AAAm by Standard & Poor's
Total Investment Pools	<u>\$ 76,847,955</u>	

	December 31, 2011	Rating
	Fair Value	
City of Houston General Pool	\$ 35,464,259	AAA by Fitch
TexSTAR	<u>22,978,392</u>	AAAm by Standard & Poor's
Total Investment Pools	<u>\$ 58,442,651</u>	

6. PROPERTY, PLANT, AND EQUIPMENT — NET

The changes in the Corporation's property, plant, and equipment for the years ended December 31, 2012 and 2011, were as follows:

	January 1, 2012	Additions	Retirements	December 31, 2012
Property, plant, and equipment, not subject to depreciation:				
Land	\$ 12,997,872	\$ -	\$ -	\$ 12,997,872
Work in process	<u>39,754</u>	<u>7,991,387</u>	<u>(3,859,917)</u>	<u>4,171,224</u>
Total property, plant, and equipment, not subject to depreciation	<u>13,037,626</u>	<u>7,991,387</u>	<u>(3,859,917)</u>	<u>17,169,096</u>
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	243,849,412	-	-	243,849,412
Furnishings and equipment	<u>38,336,418</u>	<u>3,859,917</u>	<u>-</u>	<u>42,196,335</u>
Total property, plant, and equipment, subject to depreciation	<u>282,185,830</u>	<u>3,859,917</u>	<u>-</u>	<u>286,045,747</u>
Less accumulated depreciation for:				
Hotel and garage buildings	(50,376,383)	(6,252,549)	-	(56,628,932)
Furnishings and equipment	<u>(22,188,104)</u>	<u>(2,952,990)</u>	<u>-</u>	<u>(25,141,094)</u>
Total accumulated depreciation	<u>(72,564,487)</u>	<u>(9,205,539)</u>	<u>-</u>	<u>(81,770,026)</u>
Total property, plant, and equipment — net	<u>\$ 222,658,969</u>	<u>\$ 2,642,489</u>	<u>\$ (3,859,917)</u>	<u>\$ 221,444,817</u>
	January 1, 2011	Additions	Retirements	December 31, 2011
Property, plant, and equipment, not subject to depreciation:				
Land	\$ 11,488,170	\$ 1,509,702	\$ -	\$ 12,997,872
Work in process	<u>-</u>	<u>12,487,661</u>	<u>(12,447,907)</u>	<u>39,754</u>
Total property, plant, and equipment, not subject to depreciation	<u>11,488,170</u>	<u>13,997,363</u>	<u>(12,447,907)</u>	<u>13,037,626</u>
Property, plant, and equipment, subject to depreciation:				
Hotel and garage buildings	243,849,412	-	-	243,849,412
Furnishings and equipment	<u>44,101,057</u>	<u>12,475,739</u>	<u>(18,240,378)</u>	<u>38,336,418</u>
Total property, plant, and equipment, subject to depreciation	<u>287,950,469</u>	<u>12,475,739</u>	<u>(18,240,378)</u>	<u>282,185,830</u>
Less accumulated depreciation for:				
Hotel and garage buildings	(44,123,834)	(6,252,549)	-	(50,376,383)
Furnishings and equipment	<u>(38,845,974)</u>	<u>(1,582,508)</u>	<u>18,240,378</u>	<u>(22,188,104)</u>
Total accumulated depreciation	<u>(82,969,808)</u>	<u>(7,835,057)</u>	<u>18,240,378</u>	<u>(72,564,487)</u>
Total property, plant, and equipment — net	<u>\$ 216,468,831</u>	<u>\$ 18,638,045</u>	<u>\$ (12,447,907)</u>	<u>\$ 222,658,969</u>

7. NOTE PAYABLE

The Corporation's note payable and related premium for the years ended December 31, 2012 and 2011, were as follows:

	January 1, 2012	Payments/ Amortization	Effect of City's Refunding	December 31, 2012
Note payable:				
Note payable	\$ 253,970,000	\$ (12,720,000)	\$ 280,000	\$ 241,530,000
Premium — net of discount	<u>4,348,252</u>	<u>(1,424,790)</u>	<u>2,544,170</u>	<u>5,467,632</u>
Total note payable	<u>\$ 258,318,252</u>	<u>\$ (14,144,790)</u>	<u>\$ 2,824,170</u>	<u>\$ 246,997,632</u>
	January 1, 2011	Payments/ Amortization	Effect of City's Refunding	December 31, 2011
Note payable:				
Note payable	\$ 255,920,000	\$ (10,415,000)	\$ 8,465,000	\$ 253,970,000
Premium — net of discount	<u>(608,421)</u>	<u>(676,755)</u>	<u>5,633,428</u>	<u>4,348,252</u>
Total note payable	<u>\$ 255,311,579</u>	<u>\$ (11,091,755)</u>	<u>\$ 14,098,428</u>	<u>\$ 258,318,252</u>

Payment of the Corporation's note payable to the City is based on the amortization of the City hotel-allocated bonds. Scheduled principal and interest payments on debt are summarized as follows:

Years Ending December 31	Principal	Interest	Total
2013	\$ 9,875,000	\$ 9,079,409	\$ 18,954,409
2014	7,840,000	8,493,381	16,333,381
2015	7,835,000	8,101,381	15,936,381
2016	8,310,000	7,709,631	16,019,631
2017	8,710,000	7,294,131	16,004,131
2018–2022	49,735,000	31,751,477	81,486,477
2023–2027	62,330,000	23,140,394	85,470,394
2028–2032	70,700,000	11,137,638	81,837,638
2033–2034	<u>16,195,000</u>	<u>624,960</u>	<u>16,819,960</u>
Total	<u>\$ 241,530,000</u>	<u>\$ 107,332,402</u>	<u>\$ 348,862,402</u>

On August 31, 2011, the City issued Hotel Occupancy Tax 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 note payable was similarly affected.

On August 15, 2012, the City issued \$41,525,000 of Convention & Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2012 with 5% coupons. The true interest cost was 4.80%. The bonds mature in varying amounts from 2026 to 2033. Proceeds were used to refund \$41,245,000 of the 2001B2 Convention & Entertainment HOT and Special Revenue Refunding Bonds. Net present value savings totaled \$1.9 million or 4.67% of the refunded bonds and reduced total debt service by \$1.9 million.

The portion of the note payable relating to the City's fixed-rate bonds carries interest rates ranging from 1.5% to 5.25% for \$166,530,000 of principal. The remaining \$75,000,000 relating to the City's variable rate bonds is issued as seven-day auction rate securities, with 10% being the maximum interest rate permitted. The variable rate at December 31, 2012 and 2011, was approximately 0.50% and 0.44%, respectively. Fees on the variable-rate bonds are 0.27% per year. 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, 2012, on the variable-rate bonds, plus expenses, for a total variable rate of 0.77%. The note payable is secured with a deed of trust and a security interest in certain parcels of land.

The Corporation's allocable portion of the note premiums, net of discounts, is amortized over the term of the note using the effective interest method. Amortization on such amounts totaled \$1,424,790 and \$676,756 for the years ended December 31, 2012 and 2011, respectively.

8. RELATED-PARTY TRANSACTIONS

The Consolidation Interlocal Agreement provides for the City to withdraw excess funds to cover costs and expenses related to the operation of the Department. In July 2009, the Corporation received notice from the City requesting the first of 10 annual payments of \$300,000 per the provision of the agreement. As of December 31, 2012, four of the 10 payments have been made. No additional funds were drawn by the City in 2011 or 2012.

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, 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 has entered into a hotel management agreement on March 21, 2001, with the Hilton Hotels Corporation (the “Hotel Operator”). The agreement has a term of 15 years and commenced with the opening of the Hotel. Under the terms of the agreement, the Hotel Operator has agreed to manage, operate, and market the Hotel on behalf of the Corporation. For providing such services, the Hotel Operator will receive a management fee consisting of a base management fee and subordinated management fee. The management fee is adjusted annually based on the percent change in the competitive set’s prior 12-month revenue per available room. From 2011 to 2012, the base management fee expense increased \$231,780 from \$2,027,288 to \$2,259,068, respectively.

The payment of the subordinated management fee is contingent on first generating sufficient operating cash flow (as defined) to fund certain reserves and provide for the payment to the City of a cumulative preferred return, as discussed below. Upon termination or expiration of the management agreement, the accrued and unpaid subordinated management fees will be due and payable. The subordinated management fee expense is \$1,236,750 and \$1,091,881 for the years ended December 31, 2012 and 2011, respectively. The accrued subordinated management fee of \$8,089,991 and \$6,853,241 is included in long-term liabilities at December 31, 2012 and 2011, respectively.

During 2003, under the terms of the management agreement, the Hotel Operator paid the Corporation a fee of \$6 million, which was used as a source of funds for project costs. The fee is in the form of an interest free, self-amortizing loan, the principal balance of which reduces, without payment, 1/180th per month coterminous with the hotel management agreement. For the years ended December 31, 2012 and 2011, amortization of the deferred fee totaled \$400,000 for each year and was recorded as a reduction of the management fee. In the event the management agreement with the Hotel Operator is terminated prior to its expiration date, the unamortized portion of the fee will be payable to the Hotel Operator. At December 31, 2012 and 2011, the deferred fee from Hotel Operator totaled \$2,366,667 and \$2,766,667, respectively.

Preferred Return — In accordance with the Consolidation Interlocal Agreement and the hotel 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. During 2011, preferred return payments totaling \$4,008,849 was made to the City. In 2012, the preferred return payment has been retained by the Corporation, since the Department venues operations have moved to the Corporation.

11. RISK MANAGEMENT

As the owner of the hotel operated as Hilton Americas — Houston (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 it is exposed to. 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.

12. RESTATEMENT OF STATEMENT OF NET POSITION

The Board codification identifies items that were previously reported as assets and liabilities that should be restated as deferred outflows of resources or deferred inflows of resources going forward. The Corporation identified two items that have been restated under this requirement, effective with the 2012 financial report.

- A. **Deferred Amounts from Refunding of Debts** — When the Corporation refunded existing debt, the difference between the reacquisition price and the carrying amount of the refunded debt resulted in a loss on refunding. The losses were reported as other assets in the past. According to the GASB No. 65, it should be recorded as deferred outflow of resources. In 2012 and 2011, the unamortized losses on refunding of debts were \$1,661,106 and \$406,397 respectively, which are reported as deferred outflows of resources in this year’s financial statements.
- B. **Debt Issuance Costs** — The Board evaluated these costs and concluded that with the exception of prepaid insurance, these costs relate to services provided in the current period and thus they should be expensed in the current period. The previous practice related to issuance costs was to record these as assets and amortize them over the life of the related debt issue. As a result of the implementation of GASB Statements No. 63 and No. 65, the issuance cost of \$661,781 in 2011 and \$292,040 in 2010 was reclassified as interest expense from other assets and the issuance cost related to period prior to 2010 of \$950,036 was reclassified to net position from other assets. The Corporation’s debt issuance costs totaled \$468,979 in 2012, which is recorded as interest expense.

13. SUBSEQUENT EVENTS

Houston First Holdings, LLC (HFH), a wholly owned subsidiary of Houston First Corporation, was formed on March 4, 2013, 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 and its parking garage. On April 3, 2013, HFH closed a \$125,000,000 mortgage loan with The Variable Annuity Life Insurance Company, which is secured by a deed of trust on the Hilton, its parking garage, the improvements located thereon, and certain personal property. The proceeds will be used to further economic development in and around the George R. Brown Convention Center and the Hilton, including, but not limited to, a new 1,000-room convention center hotel at the north end of the Convention Center, a 1,800-space parking garage also on the north end of the Convention Center, and residential and retail opportunities.

The initial advance on the loan was funded on April 4, 2013, at an initial interest rate (“Initial Interest Rate”) of 3.9%. Each subsequent advance shall bear interest at the greater of the (i) Initial Interest Rate or (ii) 270 basis points plus the semiannual yield on the Treasury Constant Maturity Series with maturity equal to seven years. The loan requires interest-only payments until it matures on May 1, 2020.

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