

OFFICIAL STATEMENT

NEW ISSUES – BOOK-ENTRY ONLY

RATINGS: Fitch: "A+"  
S&P: "A"  
SEE "RATINGS" HEREIN

In the opinion of Co-Bond Counsel, under existing law, (i) (A) interest on the Series 2012A Bonds (as defined below) is excludable from gross income for federal income tax purposes except for any period a Series 2012A Bond is held by a person who, within the meaning of section 147(a) of the Internal Revenue Code, as amended, is a "substantial user" or a "related person" to a "substantial user" of the facilities financed or refinanced with the proceeds of the Series 2012A Bonds, as described under "TAX MATTERS" herein, and (B) interest on the Series 2012A Bonds is an item of tax preference that is includable in alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on individuals and corporations, and (ii) (A) interest on the Series 2012B Bonds (as defined below) is excludable from gross income for federal income tax purposes, and (B) interest on the Series 2012B Bonds is not an item of tax preference that is includable in alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on individuals. See "TAX MATTERS" herein for a discussion of the opinion of Co-Bond Counsel, including a description of alternative minimum tax consequences for corporations holding Series 2012B Bonds.



**\$503,720,000**  
**CITY OF HOUSTON, TEXAS**  
**AIRPORT SYSTEM**



consisting of

**\$286,585,000**  
**SUBORDINATE LIEN REVENUE**  
**REFUNDING BONDS,**  
**SERIES 2012A (AMT)**

**\$217,135,000**  
**SUBORDINATE LIEN REVENUE**  
**REFUNDING BONDS,**  
**SERIES 2012B (NON-AMT)**

Interest Accrual Date: Date of Delivery

CUSIP Prefix: 442348

Due: As shown on inside cover

This Official Statement is provided to furnish information in connection with the offering by the City of Houston, Texas (the "City") of its Airport System Subordinate Lien Revenue Refunding Bonds, Series 2012A (AMT) (the "Series 2012A Bonds") and Airport System Subordinate Lien Revenue Refunding Bonds, Series 2012B (Non-AMT) (the "Series 2012B Bonds") and, together with the Series 2012A Bonds, the "Series 2012 Bonds". The Series 2012 Bonds will be issued in fully registered form in denominations of \$5,000 or any integral multiple thereof.

Proceeds of the sale of the Series 2012A Bonds will be used to (i) refund certain of the City's Airport System Subordinate Lien Bonds as more specifically described in SCHEDULE I and collectively referred to herein as the "2012A Refunded Bonds" and (ii) pay related costs of issuance of the Series 2012A Bonds. Proceeds of the sale of the Series 2012B Bonds will be used to (i) refund certain of the City's Airport System Subordinate Lien Bonds as more specifically described in SCHEDULE I and collectively referred to herein as the "2012B Refunded Bonds," and (ii) pay related costs of issuance of the Series 2012B Bonds. The 2012A Refunded Bonds and the 2012B Refunded Bonds, together, are referred to herein as the "Refunded Bonds." See "PURPOSE AND PLAN OF FINANCING."

Interest on the Series 2012 Bonds will accrue from their Date of Delivery (as defined below) until maturity or prior redemption and is payable semi-annually on each July 1 and January 1 commencing July 1, 2012. The Bank of New York Mellon Trust Company, National Association (the "Paying Agent/Registrar") is the initial Paying Agent/Registrar.

The Series 2012 Bonds, when issued, will be registered in the name of Cede & Co., as registered owner and nominee for The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Series 2012 Bonds, until DTC resigns or is discharged. The Series 2012 Bonds will be available to purchasers only in book-entry form. For as long as Cede & Co. is the exclusive registered owner of the Series 2012 Bonds, the principal of and interest on the Series 2012 Bonds will be payable by the Paying Agent/Registrar to DTC, which will be responsible for making such payments to DTC Participants for subsequent remittance to the owners of beneficial interests in the Series 2012 Bonds. The purchasers of the Series 2012 Bonds will not receive certificates representing their beneficial ownership interests therein.

The Series 2012 Bonds are special obligations of the City that, together with the Outstanding Subordinate Lien Bonds and any Additional Subordinate Lien Bonds hereafter issued, are payable from and equally and ratably secured by a lien on the Net Revenues of the Houston Airport System, subject and subordinate to the prior and superior lien of Outstanding Senior Lien Obligations and Additional Senior Lien Obligations, if any, all as defined and provided in any ordinance authorizing the issuance of such bonds, and certain Funds established pursuant to such ordinances. See "COVENANTS AND TERMS OF THE ORDINANCE."

THE SERIES 2012 BONDS DO NOT CONSTITUTE AN INDEBTEDNESS OR GENERAL OBLIGATION OF THE CITY. OWNERS OF THE SERIES 2012 BONDS SHALL NEVER HAVE THE RIGHT TO DEMAND PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE SERIES 2012 BONDS FROM ANY FUNDS RAISED OR TO BE RAISED BY TAXATION.

The Series 2012 Bonds are subject to redemption prior to maturity, as described herein. See "THE SERIES 2012 BONDS – Redemption."

**SEE INSIDE COVER PAGES FOR MATURITY, PRICING SCHEDULES, AND CUSIP NUMBERS**

This cover page is not intended to be a summary of the terms of, or the security for, the Series 2012 Bonds. Investors are advised to read the Official Statement in its entirety to obtain information essential to the making of an informed investment decision.

The Series 2012 Bonds are offered by the Underwriters listed below when, as and if issued by the City and accepted by the Underwriters, subject to the approving opinion of the Attorney General of the State of Texas and the opinion of Bracewell & Giuliani LLP, Houston, Texas, and Bates & Coleman, P.C., Houston, Texas, Co-Bond Counsel for the City, as to the validity of the issuance of the Series 2012 Bonds under the Constitution and the laws of the State of Texas. Certain matters will be passed upon for the City by its Special Disclosure Co-Counsel, Haynes and Boone, LLP, Houston, Texas and Bratton & Associates, Houston, Texas. Certain other legal matters will be passed upon for the Underwriters by its counsel, Fulbright & Jaworski L.L.P., Houston, Texas. The Series 2012 Bonds are expected to be available for delivery through the facilities of DTC on or about April 5, 2012 ("Date of Delivery").

**MORGAN STANLEY**

**RAMIREZ & CO., INC.**

**RBC CAPITAL MARKETS INC.**

**BLAYLOCK ROBERT VAN, LLC**

**JEFFERIES & COMPANY**

**WELLS FARGO SECURITIES**

## MATURITY AND PRICING SCHEDULE

**\$286,585,000**  
**CITY OF HOUSTON, TEXAS**  
**AIRPORT SYSTEM**  
**SUBORDINATE LIEN REVENUE REFUNDING BONDS, SERIES 2012A (AMT)**

**CUSIP PREFIX 442348<sup>(3)</sup>**

<u>Maturity (July 1)<sup>(1)</sup></u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Initial Yield</u>	<u>CUSIP Suffix<sup>(3)</sup></u>
2016	\$ 3,040,000	5.000%	1.580%	5U8
2017	3,190,000	5.000	1.850	5V6
2018	5,040,000	5.000	2.260	5W4
2019	7,960,000	5.000	2.590	5X2
2020	8,355,000	5.000	2.920	5Y0
2021	8,785,000	5.000	3.220	5Z7
2022	5,035,000	5.000	3.420	6A1
2023	33,535,000	5.000	3.560 <sup>(2)</sup>	6B9
2024	35,220,000	5.000	3.690 <sup>(2)</sup>	6C7
2025	27,875,000	5.000	3.790 <sup>(2)</sup>	6D5
2026	8,195,000	5.000	3.890 <sup>(2)</sup>	6E3
2027	11,150,000	5.000	3.980 <sup>(2)</sup>	6F0
2028	11,720,000	5.000	4.020 <sup>(2)</sup>	6G8
2029	9,880,000	5.000	4.070 <sup>(2)</sup>	6H6
2030	10,375,000	5.000	4.140 <sup>(2)</sup>	6J2
2031	56,495,000	5.000	4.150 <sup>(2)</sup>	6K9
2032	40,735,000	5.000	4.200 <sup>(2)</sup>	6L7

<sup>(1)</sup> The Series 2012A Bonds maturing on or after July 1, 2023, are subject to optional redemption by the City, in whole or in part, on July 1, 2022, or any date thereafter, at a redemption price of par plus accrued interest from the most recent interest payment date to, but not including, the redemption date. See "THE SERIES 2012 BONDS – Redemption."

<sup>(2)</sup> Yields shown are calculated to the first optional redemption date.

<sup>(3)</sup> Copyright 2011, American Bankers Association. CUSIP numbers for the Series 2012 Bonds have been assigned by Standard & Poor's CUSIP Service Bureau, a Division of The McGraw-Hill Companies, Inc. and are included solely for the convenience of the owners of the Series 2012 Bonds. Neither the City, the Co-Financial Advisors nor the Underwriters are responsible for the selection or correctness of the CUSIP numbers set forth herein.

## MATURITY AND PRICING SCHEDULE

**\$217,135,000**  
**CITY OF HOUSTON, TEXAS**  
**AIRPORT SYSTEM**  
**SUBORDINATE LIEN REVENUE REFUNDING BONDS, SERIES 2012B (NON-AMT)**

**CUSIP PREFIX 442348<sup>(3)</sup>**

<u>Maturity (July 1)<sup>(1)</sup></u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Initial Yield</u>	<u>CUSIP Suffix<sup>(3)</sup></u>
2021	\$ 4,930,000	5.000%	2.640%	6M5
2022	4,845,000	5.000	2.840	6N3
2023	5,085,000	5.000	2.990 <sup>(2)</sup>	6P8
2024	5,340,000	5.000	3.120 <sup>(2)</sup>	6Q6
2025	5,610,000	5.000	3.220 <sup>(2)</sup>	6R4
2026	5,885,000	5.000	3.320 <sup>(2)</sup>	6S2
2027	40,075,000	5.000	3.410 <sup>(2)</sup>	6T0
2028	42,090,000	5.000	3.470 <sup>(2)</sup>	6U7
2029	6,825,000	5.000	3.540 <sup>(2)</sup>	6V5
2030	7,165,000	5.000	3.620 <sup>(2)</sup>	6W3
2031	55,805,000	5.000	3.670 <sup>(2)</sup>	6X1
2032	33,480,000	5.000	3.730 <sup>(2)</sup>	6Y9

<sup>(1)</sup> The Series 2012B Bonds maturing on or after July 1, 2023, are subject to optional redemption by the City, in whole or in part, on July 1, 2022, or any date thereafter, at a redemption price of par plus accrued interest from the most recent interest payment date to, but not including, the redemption date. See "THE SERIES 2012 BONDS – Redemption."

<sup>(2)</sup> Yields shown are calculated to the first optional redemption date.

<sup>(3)</sup> Copyright 2011, American Bankers Association. CUSIP numbers for the Series 2012 Bonds have been assigned by Standard & Poor's CUSIP Service Bureau, a Division of The McGraw-Hill Companies, Inc. and are included solely for the convenience of the owners of the Series 2012 Bonds. Neither the City, the Co-Financial Advisors nor the Underwriters are responsible for the selection or correctness of the CUSIP numbers set forth herein.

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THE SERIES 2012 BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACT. THE REGISTRATION OR QUALIFICATION OF THE SERIES 2012 BONDS IN ACCORDANCE WITH APPLICABLE PROVISIONS OF SECURITIES LAW OF THE STATES IN WHICH THE SERIES 2012 BONDS HAVE BEEN REGISTERED OR QUALIFIED AND THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN OTHER STATES CANNOT BE REGARDED AS A RECOMMENDATION THEREOF. THE SERIES 2012 BONDS HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

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

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

This Official Statement is delivered in connection with the sale of securities referred to herein and may not be reproduced or used, in whole or in part, for any other purposes. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Series 2012 Bonds in any jurisdiction in which it is unlawful to make such offer, solicitation, or sale. No dealer, salesperson, or other person has been authorized by the City to give any information or to make any representation other than those contained herein, and, if given or made, such other information or representation must not be relied upon as having been authorized by the City, the Underwriters, or any other person. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the matters described herein since the date hereof.

The prices and other terms respecting the offering and sale of the Series 2012 Bonds may be changed from time to time by the Underwriters after such Bonds are released for sale, and the Series 2012 Bonds may be offered and sold at prices other than the initial offering prices, including to dealers who may sell the Series 2012 Bonds into investment accounts.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE SERIES 2012 BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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**City of Houston, Texas**

**ELECTED OFFICIALS**

**Annise D. Parker, Mayor**

**Ronald C. Green, City Controller**

**CITY COUNCIL**

Council Member, District A.....	Helena Brown	Council Member, District I.....	James G. Rodriguez
Council Member, District B.....	Jerry Davis	Council Member, District J.....	Mike Laster
Council Member, District C.....	Ellen Cohen	Council Member, District K.....	Larry Green
Council Member, District D.....	Wanda Adams	Council Member, At-Large Position 1.....	Stephen C. Costello
Council Member, District E.....	Mike Sullivan	Council Member, At-Large Position 2.....	Andrew C. Burks, Jr.
Council Member, District F.....	Al Hoang	Council Member, At-Large Position 3.....	Melissa Noriega
Council Member, District G.....	Oliver Pennington	Council Member, At-Large Position 4.....	C.O. "Brad" Bradford
Council Member, District H.....	Edward Gonzales	Council Member, At-Large Position 5.....	Jack Christie

**APPOINTED OFFICIALS**

City Attorney .....	David M. Feldman
Deputy City Controller .....	Shawnell Holman
Director, Department of Finance .....	Kelly Dowe
Director, Houston Airport System .....	Mario C. Diaz
City Secretary .....	Anna Russell
Chief Financial Advisor, Mayor's Office .....	James Moncur

**CONSULTANTS AND ADVISORS**

Co-Financial Advisors .....	First Southwest Company TKG & Associates LLC
Co-Bond Counsel.....	Bracewell & Giuliani LLP Bates & Coleman, P.C.
Special Disclosure Co-Counsel.....	Haynes and Boone, LLP Bratton & Associates

**FINANCING WORKING GROUP MEMBERS**

Houston Airport System .....	Kirk Rummel Diane Ruscitti Kenneth Gregg Willa Lockhart Susan Taylor
Office of the City Attorney .....	Gary L. Wood Sameera Mahendru
Department of Finance.....	Jennifer Olenick Jaime Alvarez Veronica Lizama
Office of the City Controller.....	Asha Patnaik Kendrack Lewis

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## TABLE OF CONTENTS

PURPOSE AND PLAN OF FINANCING .....	1	Availability of PFCs.....	44
Series 2012A Bonds .....	1	Airport Security.....	44
Series 2012B Bonds.....	2	Hurricane Activity.....	44
The Refunded Bonds .....	2	Changes in Federal Legislation Relating to the Wright Amendment .....	44
SOURCES AND USES OF FUNDS .....	3	General Factors Affecting Air Traffic at the Houston Airport System .....	45
THE SERIES 2012 BONDS .....	3	Financial Condition of the Airlines .....	45
General.....	3	Cost and Completion Schedule of Houston Airport System Capital Improvement Program .....	46
Redemption.....	4	Airport Capital Markets Access.....	47
Ownership.....	4	Parking and Concession Revenues .....	47
Transfers and Exchanges.....	5	Effect of Airline Bankruptcies .....	47
SECURITY FOR THE SERIES 2012 BONDS.....	5	THE CITY AND CITY FINANCIAL INFORMATION .....	48
Bondholders' Remedies.....	7	Governmental Structure.....	48
Flow of Funds.....	8	Home-Rule Charter.....	49
Debt Service Reserves.....	9	City Interest Rate Swap Policy.....	49
Additional Reserves and Other Funds.....	9	Investment of Moneys.....	50
RESERVE FUNDS AND RESERVE FUND SURETY POLICIES .....	10	Health Care Benefits for Retired Employees.....	50
Reserve Fund for the Subordinate Lien Bonds .....	10	Employee Pension Funds.....	52
Reserve Fund Surety Policies for Senior Lien Obligations .....	11	Schedule 9: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability.....	53
COVENANTS AND TERMS OF THE ORDINANCE.....	11	City Charter Tax and Revenue Limitations .....	54
Rate Covenant.....	11	LITIGATION AND REGULATION .....	55
Additional Houston Airport System Bonds .....	12	Houston Airport System Claims and Litigation .....	55
Amendments to Bond Ordinances.....	12	Other Claims and Litigation Affecting the City .....	55
Houston Airport System Ordinance Amendments.....	13	Environmental Regulation .....	55
THE HOUSTON AIRPORT SYSTEM.....	14	Air Emissions Controls.....	55
The Houston Airport System.....	14	State Legislation.....	56
Effects of Recent Merger Activity on the Houston Airport System .....	14	RATINGS .....	56
Houston Airport System Facilities .....	14	VERIFICATION OF MATHEMATICAL ACCURACY .....	57
Management .....	18	TAX MATTERS.....	57
Airport Service Region.....	20	Tax Exemption.....	57
Houston Airport System Strategic Plan .....	22	Additional Federal Income Tax Considerations .....	58
Non-Airline Airport Initiatives.....	23	LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS .....	59
Houston Airport System Capital Improvement Program .....	23	CONTINUING DISCLOSURE.....	59
HOUSTON AIRPORT SYSTEM OPERATING STATISTICS.....	26	Annual Reports .....	59
Airlines Utilizing the Houston Airport System.....	27	Certain Event Notices .....	60
Schedule 1: Passenger Statistics.....	28	Availability of Information.....	60
Schedule 1A: Total Enplaned Passengers for the Houston Airport System.....	29	Limitations and Amendments.....	60
Schedule 2: Airline Market Shares.....	30	Compliance with Prior Undertakings .....	61
Schedule 3: Total Aircraft Operations and Aircraft Landed Weight .....	32	No Continuing Disclosure Undertakings by Airlines.....	61
Schedule 4: Total System Cargo Activity.....	32	LEGAL PROCEEDINGS.....	61
HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION.....	33	CO-FINANCIAL ADVISORS.....	62
Sources of Revenues.....	33	INDEPENDENT AUDITORS .....	62
Schedule 5: Selected Financial Information.....	33	UNDERWRITING .....	62
Schedule 6: Summary of Certain Fees and Charges.....	36	FORWARD LOOKING STATEMENTS .....	63
DEBT SERVICE REQUIREMENTS OF HOUSTON AIRPORT SYSTEM BONDS .....	37	GENERAL INFORMATION.....	63
Schedule 7: Houston Airport System Debt Service Requirements Schedule.....	37	SCHEDULE I - SCHEDULE OF REFUNDED BONDS	
Schedule 8: Houston Airport System Outstanding Debt .....	38	APPENDIX A - AIRPORT SYSTEM FUND FINANCIAL STATEMENTS	
Schedule 8A: Cash and Liquidity.....	39	APPENDIX B-1 - THE ORDINANCE	
HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS.....	39	APPENDIX B-2 - DESCRIPTION OF AMENDMENTS	
Airport Use and Lease Agreements and Second Amended and Restated Special Facilities Lease Agreement .....	39	APPENDIX C - FORM OF OPINION OF CO-BOND COUNSEL	
Other Significant Airport Agreements .....	41	APPENDIX D - SUMMARY OF SCHEDULES RELATED TO CONTINUING DISCLOSURE OF INFORMATION	
THE AIRLINE INDUSTRY FINANCIAL INFORMATION.....	43	APPENDIX E - DEPOSITORY TRUST COMPANY	
INVESTMENT CONSIDERATIONS.....	43		
Airline Concentration; Effect of Airline Industry Consolidation.....	43		
FAA Reauthorization.....	44		

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**OFFICIAL STATEMENT**

**\$503,720,000  
CITY OF HOUSTON, TEXAS  
AIRPORT SYSTEM**

**CONSISTING OF**

**\$286,585,000  
SUBORDINATE LIEN REVENUE  
REFUNDING BONDS,  
SERIES 2012A (AMT)**

**\$217,135,000  
SUBORDINATE LIEN REVENUE  
REFUNDING BONDS,  
SERIES 2012B (Non-AMT)**

This Official Statement, including the cover page, schedules and appendices hereto, is provided to furnish information in connection with the offer and sale by the City of Houston, Texas (the "City") of its Airport System Subordinate Lien Revenue Refunding Bonds, Series 2012A (AMT) (the "Series 2012A Bonds"), and Airport System Subordinate Lien Revenue Refunding Bonds, Series 2012B (Non-AMT) (the "Series 2012B Bonds" and, together with the Series 2012A Bonds, the "Series 2012 Bonds"). The Series 2012 Bonds are being issued pursuant to Chapters 1201, 1207, 1371 and 1503, Texas Government Code, as amended, an ordinance adopted by the City Council of the City on February 8, 2012 (the "Ordinance"), and the Officers Pricing Certificate authorized by the Ordinance.

The City manages and operates the Houston Airport System as an enterprise system of the City. The Houston Airport System is currently comprised of the following facilities, each of which the City owns and operates: George Bush Intercontinental Airport/Houston ("Intercontinental"), William P. Hobby Airport ("Hobby") and Ellington Airport ("Ellington"). United Airlines ("United")<sup>1</sup> is the largest air carrier operating at Intercontinental and Southwest Airlines, Inc. ("Southwest") is the largest air carrier operating at Hobby. For additional information about the Houston Airport System, see "THE HOUSTON AIRPORT SYSTEM."

The City is the fourth largest city in the nation and the largest city in Texas. Based on 2010 U.S. Census data, the population of the City is approximately 2.1 million and the population of the 10-county metropolitan statistical area ("Houston-Sugar Land-Baytown" or the "MSA") is approximately 5.95 million, which is the sixth largest in the United States. For additional information about the City, see "THE CITY AND CITY FINANCIAL INFORMATION."

Brief descriptions and summaries of the Series 2012 Bonds, the Houston Airport System and the Ordinance are included in this Official Statement. References herein to the Series 2012 Bonds and the Ordinance are qualified in their entirety, by reference to the Ordinance and the forms of the respective Series 2012 Bonds contained in the Officers Pricing Certificate. Houston Airport System Fund financial statements for the Fiscal Year ended June 30, 2011 are included in APPENDIX A. A glossary of defined terms is included as APPENDIX B-1 and, unless otherwise specifically defined, capitalized terms used herein have the meanings set out in APPENDIX B-1.

**PURPOSE AND PLAN OF FINANCING**

**Series 2012A Bonds**

Proceeds of the sale of the Series 2012A Bonds will be used to (i) refund certain of the City's outstanding Airport System Subordinate Lien Bonds as more specifically described in SCHEDULE I and collectively referred to herein as the "2012A Refunded Bonds" and (ii) pay related costs of issuance of the Series 2012A Bonds.

<sup>(1)</sup> United Airlines and Continental Airlines merged on October 1, 2010. The two airlines received a single operating certificate from the FAA on November 30, 2011. In early March 2012, the two airlines achieved full integration and began operating under the name "United Airlines." See "THE HOUSTON AIRPORT SYSTEM – Effects of Recent Merger Activity on the Houston Airport System – Continental/United Airlines."

## **Series 2012B Bonds**

Proceeds of the sale of the Series 2012B Bonds will be used to (i) refund certain of the City's outstanding Airport System Subordinate Lien Bonds as more specifically described in SCHEDULE I and collectively referred to herein as the "2012B Refunded Bonds" and (ii) pay related costs of issuance of the Series 2012B Bonds.

### **The Refunded Bonds**

A portion of the proceeds of the Series 2012 Bonds, together with other available funds, if any, will be used to purchase a portfolio of obligations authorized under Texas law and the ordinances authorizing the Refunded Bonds (the "Escrowed Securities") to be deposited, along with certain uninvested proceeds of the Series 2012 Bonds, in one or more escrow funds or accounts (collectively the "Refunded Bonds Escrow Fund") with The Bank of New York Mellon Trust Company, National Association, the escrow agent for the Refunded Bonds (the "Refunded Bonds Escrow Agent"), the maturing principal of and interest on which will be sufficient, together with other funds, to pay, when due, the principal of and interest on the Refunded Bonds.

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

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

Simultaneously with the issuance of the Series 2012 Bonds, the City will give, or provide irrevocable instructions to the Refunded Bonds Escrow Agent to give, notice of redemption to the owners of the Refunded Bonds in accordance with the ordinances authorizing the Refunded Bonds. The Refunded Bonds will be redeemed on dates prior to their stated maturities, on which dates money held in the Refunded Bonds Escrow Fund will be available to redeem the Refunded Bonds. See SCHEDULE I.

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## SOURCES AND USES OF FUNDS

The following table summarizes the estimated sources and uses of proceeds of the Series 2012A Bonds and Series 2012B Bonds:

	Series 2012A Bonds	Series 2012B Bonds	Total
<u>Sources of Funds:</u>			
Principal Amount	\$ 286,585,000.00	\$ 217,135,000.00	\$ 503,720,000.00
Premium	27,841,085.45	27,893,103.55	55,734,189.00
City Contribution	4,141,912.54	0.00	4,141,912.54
<b>Total Sources of Funds</b>	<b>\$ 318,567,997.99</b>	<b>\$ 245,028,103.55</b>	<b>\$ 563,596,101.54</b>
<u>Uses of Funds:</u>			
Escrowed Securities Deposit to Refunded Bonds Escrow Fund <sup>(1)</sup>	\$ 316,396,661.13	\$ 243,310,059.72	\$ 559,706,720.85
Underwriters' Discount	1,444,461.01	1,149,089.54	2,593,550.55
Costs of Issuance and Contingency <sup>(2)</sup>	726,875.85	568,954.29	1,295,830.14
<b>Total Uses of Funds</b>	<b>\$ 318,567,997.99</b>	<b>\$ 245,028,103.55</b>	<b>\$ 563,596,101.54</b>

<sup>(1)</sup> Includes cash deposit to Refunded Bonds Escrow Fund.

<sup>(2)</sup> Includes legal fees, financial advisory fees, rating agency fees, fees of the Paying Agent/Registrar and Refunded Bonds Escrow Agent and other costs of issuance.

## THE SERIES 2012 BONDS

### General

The Series 2012 Bonds are Subordinate Lien Bonds that, together with all other Subordinate Lien Bonds from time to time outstanding, are payable from and equally and ratably secured by a lien on the Net Revenues of the Houston Airport System. The lien on Net Revenues securing Subordinate Lien Bonds is subordinate and junior to the superior lien on the Net Revenues securing the Senior Lien Obligations, of which \$449,660,000 were outstanding as of December 31, 2011, and prior to the lien securing any Inferior Lien Bonds.

The Series 2012 Bonds will mature in the aggregate principal amounts and on the dates indicated on pages i, ii and iii of this Official Statement. The Series 2012 Bonds will accrue interest from the Date of Delivery, as set forth on the cover page hereof. Interest on the Series 2012 Bonds is payable each July 1 and January 1, commencing July 1, 2012, until maturity or earlier redemption. Interest on the Series 2012 Bonds will be calculated on the basis of a 360-day year composed of twelve 30-day months from the later of their issuance date or the most recent Interest Payment Date to which interest has been paid or provided for. The Bank of New York Mellon Trust Company, National Association, is the initial paying agent/registrar (the "Paying Agent/Registrar") for the Series 2012 Bonds. The Series 2012 Bonds will be issued in fully registered form in denominations of \$5,000 or any integral multiple thereof ("Authorized Denominations").

Principal of the Series 2012 Bonds is payable when due upon presentation and surrender thereof at the Principal Office of the Paying Agent/Registrar, which is currently located in Houston, Texas. Interest on the Series 2012 Bonds will be payable to the Registered Owner whose name appears in the registration books for the Series 2012 Bonds (the "Register") maintained by the Paying Agent/Registrar at the close of business on the 15th day of the calendar month immediately preceding the applicable interest payment date (the "Record Date") and shall be payable by the Paying Agent/Registrar (i) by check or draft sent by United States Mail, first class postage prepaid, to the address of the registered owner recorded in the Register or (ii) by such other method acceptable to the Paying Agent/Registrar requested by, and at the risk and expense of, the registered owner. Accrued interest payable at maturity of the Series 2012 Bonds will be paid upon presentation and surrender of such Bonds at the principal payment office of the Paying Agent/Registrar.

## **Redemption**

### ***Optional Redemption***

The Series 2012 Bonds maturing on or after July 1, 2023, are subject to optional redemption by the City prior to maturity, in whole or in part, on July 1, 2022, or any date thereafter, at a price equal to 100% of the principal amount of the Series 2012 Bonds to be redeemed, plus accrued interest to (but not including) the redemption date.

### ***Partial Redemption***

The Series 2012 Bonds may be redeemed in part only in integral multiples of \$5,000. If a Series 2012 Bond subject to redemption is in a denomination larger than \$5,000, a portion of such Series 2012 Bond may be redeemed, but only in integral multiples of \$5,000. Upon presentation and surrender of any Series 2012 Bond for redemption in part, the Paying Agent/Registrar, in accordance with the provisions of the Ordinance, shall authenticate and deliver in exchange therefor Series 2012 Bonds of like maturity and interest rate in an aggregate principal amount equal to the unredeemed portion of the Series 2012 Bonds so presented and surrendered.

### ***Selection of Bonds to be Redeemed***

In the case of any optional redemption in part of the Series 2012 Bonds, the Series 2012 Bonds to be redeemed shall be selected by the City. If less than all the Series 2012 Bonds of a stated maturity shall be called for redemption, the particular Series 2012 Bonds to be redeemed shall be selected by the Paying Agent/Registrar, in such manner as the Paying Agent/Registrar deems fair and appropriate and consistent with the requirements provided in the Series 2012 Bonds.

### ***Notice of Redemption***

In the event any of the Series 2012 Bonds are called for optional redemption, the Paying Agent/Registrar shall give notice, in the name of the City, of the redemption of such Series 2012 Bonds, which notice shall (i) specify the Series 2012 Bonds to be redeemed, the redemption date, the redemption price and the place or places where amounts due upon such redemption will be payable (which shall be the principal corporate trust office of the Paying Agent/Registrar) and, if less than all of the Series 2012 Bonds are to be redeemed, the portions of the Series 2012 Bonds to be redeemed, (ii) state any condition to such redemption and (iii) state that on the redemption date, and upon the satisfaction of any such condition, the Series 2012 Bonds to be redeemed shall cease to bear interest. CUSIP number identification shall accompany all redemption notices. Such notice may set forth any additional information relating to such redemption. Such notice shall be given by mail, postage prepaid, at least 30 days but not more than 60 days prior to the date fixed for redemption to each Registered Owner of Series 2012 Bonds to be redeemed at its address shown on the registration books kept by the Paying Agent/Registrar; provided, however, that failure to give such notice to any Registered Owner or any defect in such notice shall not affect the validity of the proceedings for the redemption of any of the other Series 2012 Bonds.

Any notice given as provided herein shall be conclusively presumed to have been duly given, whether or not the Registered Owner or Beneficial Owner receives such notice. When the Series 2012 Bonds have been called for redemption in whole or in part and due provision has been made to redeem the same as provided in the Series 2012 Bonds and in the Ordinance, the Series 2012 Bonds or portions thereof to be so redeemed shall no longer be regarded as Outstanding except for the purpose of receiving payment solely from the funds so provided for redemption, and the rights of the Registered Owners to collect interest that would otherwise accrue after the redemption date on any Series 2012 Bond or portion thereof called for redemption shall terminate on the date fixed for redemption.

## **Ownership**

The City, the Paying Agent/Registrar, and any other person may treat the person in whose name any Series 2012 Bond is registered as the absolute Owner of such Series 2012 Bond for the purpose of making and receiving payment of the principal thereof and premium, if any, thereon, and for the purpose of making and receiving payment of the interest thereon, and for all other purposes, whether or not such Series 2012 Bond is overdue, and neither the City nor the Paying Agent/Registrar shall be bound by any notice or knowledge to the contrary. All payments made to the person deemed to be

the Owner of any Series 2012 Bond in accordance with the Ordinance shall be valid and effectual and shall discharge the liability of the City and the Paying Agent/Registrar upon such Series 2012 Bond to the extent of the sums paid.

### **Transfers and Exchanges**

Beneficial ownership of the Series 2012 Bonds registered in the name of The Depository Trust Company, New York, New York (“DTC”), will initially be transferred as described under APPENDIX E – DEPOSITORY TRUST COMPANY.

So long as any Series 2012 Bonds remain Outstanding, the Paying Agent/Registrar shall keep the Register at its designated corporate trust office in which, subject to such reasonable regulations as it may prescribe, the Paying Agent/Registrar shall provide for the registration and transfer of the Series 2012 Bonds in accordance with the terms of the Ordinance. A copy of the Register shall be maintained at an office of the Paying Agent/Registrar in Texas.

Each Series 2012 Bond shall be transferable only upon the presentation and surrender thereof at the designated corporate trust office of the Paying Agent/Registrar, duly endorsed for transfer, or accompanied by an assignment duly executed by the Registered Owner or his authorized representative in form satisfactory to the Paying Agent/Registrar. Upon due presentation and surrender of any Series 2012 Bond for transfer, the Paying Agent/Registrar is required to authenticate and deliver in exchange therefor, within 72 hours after such presentation and surrender, a new Series 2012 Bond or Series 2012 Bonds, registered in the name of the transferee or transferees, in Authorized Denominations and of the same series, maturity and aggregate principal amount and bearing interest at the same rate as the Series 2012 Bond or Series 2012 Bonds so presented and surrendered.

In the event the Series 2012 Bonds are not in the DTC book-entry-only registration system, all Series 2012 Bonds shall be exchangeable upon the presentation and surrender thereof at the designated corporate trust office of the Paying Agent/Registrar for a Series 2012 Bond or Series 2012 Bonds of the same series, maturity and interest rate and in any Authorized Denomination, in an aggregate principal amount equal to the unpaid principal amount of the Series 2012 Bond or Bonds presented for exchange.

Each Series 2012 Bond delivered in accordance with the Ordinance shall be entitled to the benefits and security of the Ordinance to the same extent as the Series 2012 Bond or Bonds in lieu of which such Series 2012 Bond is delivered.

The City or the Paying Agent/Registrar may require DTC or any subsequent Registered Owner of any Series 2012 Bond to pay a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with the transfer or exchange of such Series 2012 Bond. Any fee or charge of the Paying Agent/Registrar for such transfer or exchange shall be paid by the City.

The Paying Agent/Registrar shall not be required to transfer or exchange any Series 2012 Bond during the 45-day period prior to the date fixed for redemption; provided, however, that such restriction shall not apply to the transfer or exchange by the Registered Owner of the unredeemed portion of any Series 2012 Bond called for redemption in part.

### **SECURITY FOR THE SERIES 2012 BONDS**

The Series 2012 Bonds are special obligations of the City that, together with the Outstanding Subordinate Lien Bonds and any Additional Subordinate Lien Bonds hereafter issued, are payable from and are equally and ratably secured by a lien on the Net Revenues of the Houston Airport System, the Subordinate Lien Bond Interest and Sinking Fund, and the Subordinate Lien Bond Reserve Fund, all as defined and provided in the Ordinance. See APPENDIX B-1 – THE ORDINANCE – Summary of Selected Provisions. The lien on Net Revenues securing the Series 2012 Bonds and other Subordinate Lien Bonds is junior and subordinate to the lien on Net Revenues securing the Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued.

**The Series 2012 Bonds do not constitute a general obligation of the City. Owners of the Series 2012 Bonds shall never have the right to demand payment of principal of or interest on the Series 2012 Bonds from any funds raised or to be raised by taxation.**

In addition to the definitions described below, see APPENDIX B-1 for a summary of the Ordinance, which further details the security for the Series 2012 Bonds.

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

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

Gross Revenues expressly exclude: (1) proceeds of any Houston Airport System Bonds and Inferior Lien Bonds; (2) interest or other investment income derived from Houston Airport System Bond proceeds deposited to the credit of any construction fund, or applied to fund capitalized interest, or interest or investment income required to be retained in the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund or any escrow fund in order to accumulate therein any amount or balance required to be accumulated or maintained therein pursuant to any ordinance authorizing any series of Houston Airport System Bonds; (3) any moneys received as grants, appropriations, or gifts, the use of which is limited by the grantor or donor to the construction or acquisition of the Houston Airport System facilities, except to the extent any such moneys shall be received as payments for the use of the Houston Airport System facilities; (4) any revenues derived from any Special Facilities that are pledged to the payment of Special Facilities Bonds; (5) insurance proceeds other than loss of use or business interruption insurance proceeds; (6) the proceeds of any passenger facility charge or other per-passenger charge as may be authorized under federal law including, but not limited to, those revenues defined as PFC Revenues; (7) sales and other taxes collected by the Houston Airport System on behalf of the State of Texas and any other taxing entities; (8) Federal Payments received by the Houston Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Houston Airport System Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes; (9) the net proceeds received by the City from the disposition of any Houston Airport System property; (10) Excluded Fee and Charge Revenues; and (11) any Taxable Bond Credit Revenues.

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

The following expenses are specifically excluded from the definition of Operation and Maintenance Expenses: (1) any allowance for depreciation; (2) costs of capital improvements; (3) reserves for major capital improvements, Houston Airport System operations, maintenance or repair; (4) any allowance for redemption of, or payment of interest or premium on, Houston Airport System Bonds; (5) any liabilities incurred in acquiring or improving properties of the Houston Airport System; (6) expenses of lessees under Special Facilities Leases and operation and maintenance expenses pertaining to Special Facilities to the extent they are required to be paid by such lessees pursuant to the terms of the Special Facilities Leases; (7) any charges or obligations incurred in connection with any lawful Houston Airport System purpose, including



the lease, acquisition, operation or maintenance of any facility or property benefiting the Houston Airport System, provided that the payment of such charges or obligations is expressly agreed by the payee to be payable solely from proceeds of the Airports Improvement Fund; (8) liabilities based upon the City's negligence or other ground not based on contract; and (9) so long as Federal Payments are excluded from Gross Revenues, an amount of expenses that would otherwise constitute Operation and Maintenance Expenses for such period equal to the Federal Payments for such period.

***Perfection of Security Interest in Revenues.*** The Ordinance provides that pursuant to Chapter 1208, Texas Government Code, the lien on Net Revenues created under the Ordinance is valid, effective, and perfected.

### **Bondholders' Remedies**

The Ordinance provides that if the City defaults in the payment of principal of or interest on any Subordinate Lien Bonds, including the Series 2012 Bonds, or the performance of any duty or covenant provided by law or in the Ordinance, Owners of such Subordinate Lien Bonds, including the Series 2012 Bonds, may pursue all legal remedies afforded by the Constitution and the laws of the State of Texas to compel the City to remedy such default and to prevent further default or defaults.

The Ordinance neither appoints nor makes any provision for the appointment of a trustee to protect the rights of Owners of the Series 2012 Bonds. Furthermore, the Ordinance does not provide for acceleration of maturity of the Series 2012 Bonds or for foreclosure on Net Revenues or possession of Net Revenues by a trustee or agent for Owners of the Series 2012 Bonds or for operation of the Houston Airport System by an independent third party in the event of default.

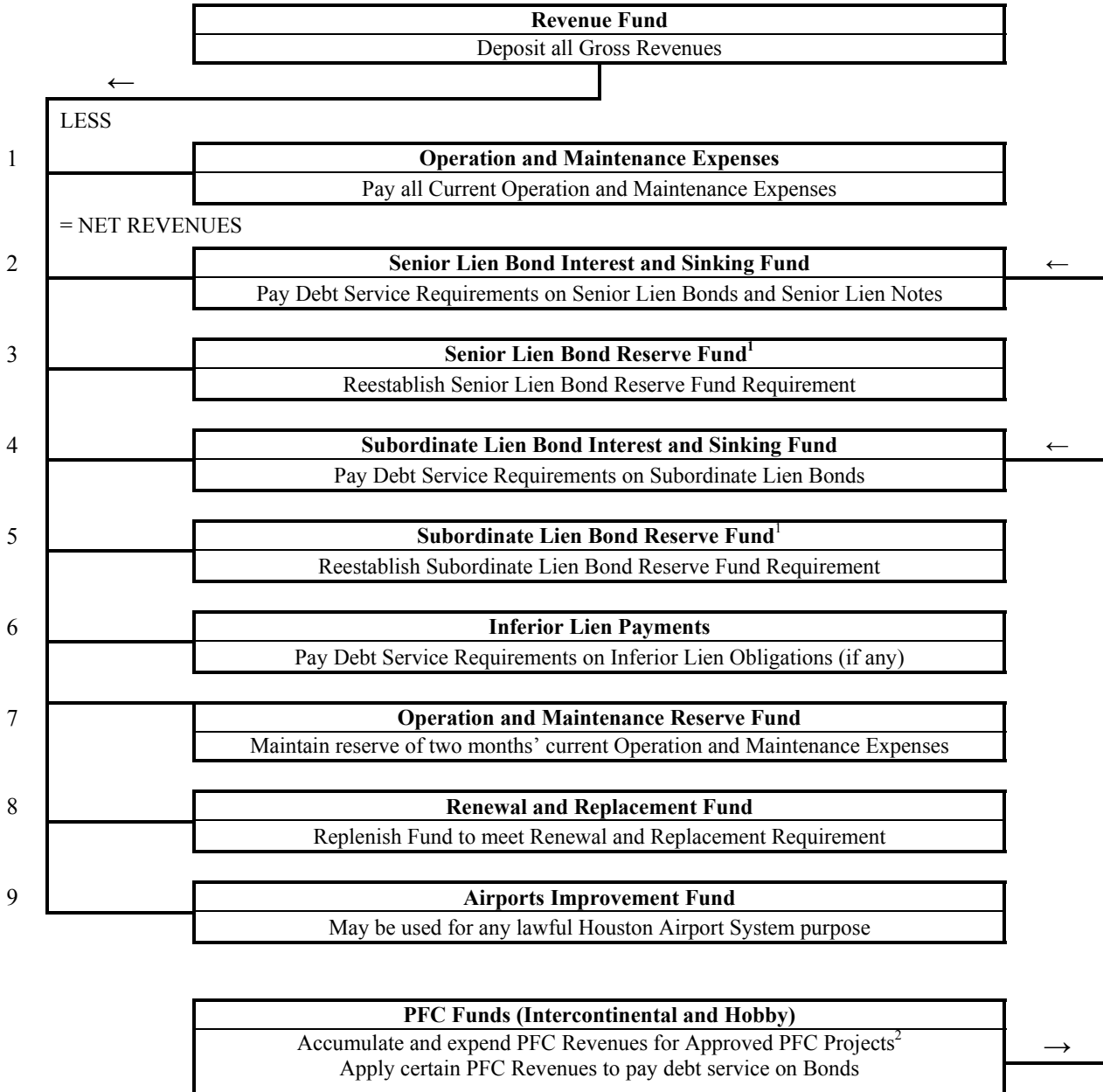
No lien has been placed on any of the physical properties comprising the Houston Airport System to secure the payment of or interest on the Series 2012 Bonds. Moreover, in the event of default, the Owners of the Series 2012 Bonds have no right or claim under the laws of the State of Texas against the Houston Airport System or any property of the City other than their right to receive payment from Net Revenues and certain Funds maintained pursuant to the Ordinance. Owners of the Series 2012 Bonds have no right to demand payment of principal of or interest or premium, if any, on the Series 2012 Bonds from any funds raised or to be raised by taxation or from any funds on deposit in any of the special Funds described in the Ordinance, except the Subordinate Lien Bond Interest and Sinking Fund, and the applicable account of the Subordinate Lien Bond Reserve Fund. Further, unless sovereign immunity is expressly waived by the Texas Legislature, local governmental immunity would be available as a defense against suits for money damages against the City or the Houston Airport System in connection with the Series 2012 Bonds. Sovereign immunity will not be waived in connection with the issuance of the Series 2012 Bonds. Accordingly, the only practical remedy in the event of a default may be a mandamus proceeding to compel the City to increase rates and charges reasonably required for the use and service of the Houston Airport System or perform its other obligations under the Ordinance, including the deposit of the Gross Revenues into the special Funds provided in the Ordinance and the application of such Gross Revenues and such special Funds in the manner required in the Ordinance. Such remedy may need to be enforced on a periodic basis because maturity of the Series 2012 Bonds is not subject to acceleration. In addition, the City's ability to comply with the Rate Covenant will be limited by contractual and competitive supply and demand constraints. See "COVENANTS AND TERMS OF THE ORDINANCE – Rate Covenant."

The City is also eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"); however, Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues, such as that of the Net Revenues of the Houston Airport System. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or bondholders of an entity that has sought protection under Chapter 9. Therefore, should the City avail itself of Chapter 9 protection from creditors, the ability to enforce any other remedies available to the registered owners, other than for the pledge of Net Revenues securing the Series 2012 Bonds, would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it.

The enforcement of a claim for payment of principal of or interest on the Series 2012 Bonds and the City's other obligations with respect to the Series 2012 Bonds are subject to the applicable provisions of the federal bankruptcy laws and to any other similar laws affecting the rights of creditors of political subdivisions generally.

**Flow of Funds**

Below is a presentation of the application of revenues under provisions of the ordinances of the Outstanding Houston Airport System Bonds. For more information about the Houston Airport System’s revenues, see “SECURITY FOR THE SERIES 2012 BONDS” and APPENDIX B-1.



<sup>1</sup> Interest income on funds on deposit in the Senior Lien Bond Reserve Fund and Subordinate Lien Bond Reserve Fund may be transferred to the related Interest and Sinking Fund, or such other funds as may be permitted by federal tax law.

<sup>2</sup> PFC Revenues are not pledged to pay debt service on any Houston Airport System Bonds, including the Series 2012 Bonds, but may be pledged or otherwise obligated, consistent with FAA regulations. Additionally, the Houston Airport System periodically transfers PFC Revenues to the Senior Lien and Subordinate Lien Bond Interest and Sinking Funds or such other account for the purpose of paying eligible debt service attributable to approved PFC projects.

## **Debt Service Reserves**

The Ordinance requires the maintenance of a Subordinate Lien Bond Reserve Fund for all Subordinate Lien Bonds and requires to be maintained therein a balance equal to the Reserve Fund Requirement (as defined in APPENDIX B-1). Within the Subordinate Lien Bond Reserve Fund, there is a Subordinate Lien Bond Reserve Fund Participant Account, which constitutes trust funds and shall be held in trust for Owners of the Subordinate Lien Bonds that are secured thereby (the "Reserve Fund Participants"). All Subordinate Lien Bonds Outstanding as of the date of adoption of the Ordinance have been declared and designated to be Reserve Fund Participants; the Series 2012 Bonds will be declared and designated to be Reserve Fund Participants in the applicable Officers Pricing Certificate. With respect to those Subordinate Lien Bonds that are Reserve Fund Participants, the Reserve Fund Requirement is equivalent to the maximum annual Debt Service Requirements on all Subordinate Lien Bonds that are Reserve Fund Participants, which amount shall be computed and recomputed upon the issuance of each series of Subordinate Lien Bonds that are Reserve Fund Participants and on each date on which Subordinate Lien Bonds that are Reserve Fund Participants are paid at maturity or optionally or mandatorily redeemed. The Subordinate Lien Bond Reserve Fund Participant Account is required to be used to pay the principal of and interest on the Subordinate Lien Bonds that are Reserve Fund Participants at any time when there is not sufficient money available in the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments on deposit in such account be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policies allocable to the Subordinate Lien Bond Reserve Fund Participant Account) and to repay amounts drawn under any Subordinate Lien Bond Reserve Fund Surety Policy allocable to such Subordinate Lien Bond Reserve Fund Participant Account for such purpose, together with interest thereon, in accordance with the terms of the City's reimbursement obligations incurred in connection with such Subordinate Lien Bond Reserve Fund Surety Policy. The Subordinate Lien Bond Reserve Participant Account may also be used to make the final payments for the retirement or defeasance of all Subordinate Lien Bonds then Outstanding that are Reserve Fund Participants.

Each increase in the Reserve Fund Requirement resulting from the issuance of Additional Subordinate Lien Bonds is required to be funded at the time of issuance and delivery of such series of Additional Subordinate Lien Bonds. The Reserve Fund Requirement may be satisfied by depositing to the credit of the Subordinate Lien Bond Reserve Fund Participant Account (in the case of Additional Subordinate Lien Bonds that are Reserve Fund Participants) or such other designated accounts (in the case of Additional Subordinate Lien Bonds that are not Reserve Fund Participants) either (1) proceeds of such Additional Subordinate Lien Bonds or other lawfully appropriated funds or (2) one or more Subordinate Lien Bond Reserve Fund Surety Policies.

The Ordinance further provides that in any month in which any account of the Subordinate Lien Bond Reserve Fund contains less than the applicable Reserve Fund Requirement, the City shall transfer from the Revenue Fund on a pro rata basis into the Subordinate Lien Bond Reserve Fund Participant Account and other designated accounts of the Subordinate Lien Bond Reserve Fund, such amounts as shall be required to permit the City to pay all reimbursement obligations under the Subordinate Lien Bond Reserve Fund Surety Policies allocable to the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, within a twelve-month period and such additional amounts as shall be sufficient to enable the City within a twelve-month period to reestablish in the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, the Reserve Fund Requirement for the Subordinate Lien Bonds secured thereby. See APPENDIX B-1 for further details regarding the Subordinate Lien Bond Reserve Fund.

In order to satisfy its obligations with respect to the Reserve Fund Requirement for the Outstanding Subordinate Lien Bonds and Outstanding Senior Lien Obligations, the City previously acquired certain Subordinate Lien Bond Reserve Fund Surety Policies and Senior Lien Bond Reserve Fund Surety Policies, respectively. The Subordinate Lien Bond Reserve Fund Participant Account and the Senior Lien Bond Reserve Fund also contain cash and investments. For a discussion regarding such policies, see "RESERVE FUNDS AND RESERVE FUND SURETY POLICIES."

## **Additional Reserves and Other Funds**

The Ordinance also provides for maintenance of an Operation and Maintenance Reserve Fund and a Renewal and Replacement Fund. The Operation and Maintenance Reserve Fund is required to be funded in an amount at least equal to two months' current Operation and Maintenance Expenses (which amount shall annually be redetermined by the Director of the Houston Airport System at the time such official submits the proposed annual Houston Airport System budget based upon either such official's recommended budget for Operation and Maintenance Expenses or estimate of actual Operation

and Maintenance Expenses for the then-current Fiscal Year). The amount required by the Ordinance to be maintained in the Renewal and Replacement Fund out of surplus funds of the Houston Airport System is \$10,000,000 (or any greater amount required by an ordinance authorizing any series of additional Houston Airport System Bonds). Unappropriated funds in the Operations and Maintenance Reserve Fund and the Renewal and Replacement Fund may be used to pay operations and maintenance expenses, if needed, among other purposes. See “Schedule 8A: Cash and Liquidity.”

## **RESERVE FUNDS AND RESERVE FUND SURETY POLICIES**

### **Reserve Fund for the Subordinate Lien Bonds**

***Reserve Fund Requirement.*** As of date hereof, the Reserve Fund Requirement for the Subordinate Lien Bonds that are Reserve Fund Participants is \$149,653,613.00. Reserve Fund Participants currently include all outstanding Subordinate Lien Bonds. The Subordinate Lien Bond Reserve Fund Participant Account is funded with cash (and allowable investments) totaling \$15,756,228.00 and certain Subordinate Lien Bond Reserve Fund Surety Policies, as described in the table below, totaling \$156,121,980.20. All amounts credited to the Subordinate Lien Bond Reserve Fund Participant Account are pledged and available to pay debt service on all Subordinate Lien Bonds that are Reserve Fund Participants, including the Series 2012 Bonds. To the extent that such amounts are needed to fund Debt Service Requirements, the City has covenanted to use cash deposits before drawing on the Subordinate Lien Bond Reserve Fund Surety Policies, and any such draws would be on a pro rata basis among such Subordinate Lien Bond Reserve Fund Surety Policies.

The Houston Airport System has never utilized any amounts or drawn upon any surety policies in the Subordinate Lien Bond Reserve Fund to pay Debt Service Requirements. Based on a variety of factors, the City may supplement the current funding of the Subordinate Lien Bond Reserve Fund with available funds of the Houston Airport System or future proceeds of Subordinate Lien Bonds.

***Subordinate Lien Bond Reserve Fund Surety Policies.*** As described above, the Reserve Fund Requirement for Subordinate Lien Bonds that are Reserve Fund Participants is partially funded by the following Subordinate Lien Bond Reserve Fund Surety Policies: (1) Financial Guaranty Insurance Corporation (“FGIC”) policies in the aggregate maximum amount of \$108,444,368.70, (2) an Assured Guaranty Municipal Corp. (“AGM”), as successor to Financial Security Assurance (“FSA”), policy in the aggregate maximum amount of \$31,921,383.50, and (3) a Syncora Guarantee (“Syncora”), as successor to XL Capital Assurance, Inc., policy in the aggregate maximum amount of \$15,756,228.00.

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The following table identifies outstanding Subordinate Reserve Fund Policies issued in prior City of Houston Airport System financings.

**Outstanding Subordinate Lien Reserve Fund Surety Policies**

<u>Reserve Fund Policy Issuer</u>	<u>Termination Date</u>	<u>Maximum Amount</u>
FGIC (reinsured as described below) <sup>1</sup>	July 1, 2017	\$ 5,494,503.70
	July 1, 2022	24,477,885.00
	July 1, 2028	32,050,000.00
	July 1, 2030	43,269,100.00
	July 1, 2032	3,152,880.00
AGM (formerly FSA)	Earlier of July 1, 2032 or the date the Series 2002A and 2002B Bonds are no longer outstanding	31,921,383.50
Syncora (formerly XL Capital Assurance Inc.) <sup>2</sup>	Earlier of July 1, 2032 or the date the Series 2002C and 2002D Bonds are no longer outstanding	15,756,228.00
<b>TOTAL COVERAGE OF ALL OUTSTANDING POLICIES:</b>		<hr/> \$156,121,980.20

<sup>1</sup> Pursuant to a Reinsurance Agreement between FGIC and MBIA Insurance Corporation (“MBIA”) dated September 30, 2008, MBIA agreed to reinsure the FGIC policies, including those relating to the Outstanding Subordinate Lien Bonds and the Senior Lien Notes described below. MBIA subsequently assigned its rights and obligations under such Reinsurance Agreement to National Public Finance Guarantee Corporation (f/k/a MBIA Insurance Corporation of Illinois).

<sup>2</sup> In 2010, the New York State Insurance Department approved Syncora’s remediation plan and authorized Syncora’s payment of new claims. Notwithstanding that the Syncora policy is available for claims, the Houston Airport System maintains a balance of cash (or allowable investments) approximately equal to the value of the Syncora policy in the Subordinate Lien Bond Reserve Fund Participant Account.

**Reserve Fund Surety Policies for Senior Lien Obligations**

The City also maintains separate reserve accounts within the Senior Lien Bond Reserve Fund for the Senior Lien Bonds and for the Senior Lien Notes. As of the date hereof, the Reserve Fund Requirement for the Outstanding Senior Lien Bonds is \$33,095,993.76, which is funded by cash (or allowable investments), and the Reserve Fund Requirement for the Senior Lien Notes is \$24,749,000, which is funded by three surety policies issued by FGIC (and reinsured as described above) in an aggregate maximum amount of approximately \$12,374,996. Two of the surety policies securing the Senior Lien Notes, in an aggregate maximum amount of approximately \$6,374,996, terminate on October 25, 2023. The third surety policy, in the maximum amount of approximately \$7,000,000, terminates on July 1, 2030.

**COVENANTS AND TERMS OF THE ORDINANCE**

The following section describes certain covenants and other terms of the Ordinance. Capitalized terms used in this section but not otherwise defined have the meanings given to such terms in APPENDIX B-1.

**Rate Covenant**

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

Debt Service Requirements do not include any interest on Houston Airport System Bonds to the extent that the provision for the payment of such interest has been made by (1) appropriating for such purpose amounts sufficient to provide for the full and timely payment of such interest either from the proceeds of Houston Airport System Bonds, from

interest earned or to be earned thereon, from other Houston Airport System funds other than Net Revenues, or from any combination of such sources, (2) depositing such amounts (except interest to be earned, which will be deposited as received) into a fund or account for capitalized interest, the proceeds of which are required to be transferred as needed into the Senior Lien Bond Interest and Sinking Fund or the Subordinate Lien Bond Interest and Sinking Fund, or (3) by irrevocably committing funds other than Net Revenues including, but not limited to, PFC Revenues or Excluded Fee and Charge Revenues to be paid by the Houston Airport System. See APPENDIX B-1 and “COVENANTS AND TERMS OF THE ORDINANCE – Amendments to Bond Ordinances.”

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

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

### **Additional Houston Airport System Bonds**

The Ordinance permits the City to issue, for any lawful Houston Airport System purpose, Additional Subordinate Lien Bonds and Additional Senior Lien Obligations and Inferior Lien Bonds, if certain conditions are satisfied. For detailed information relating to the issuance of additional Houston Airport System Bonds, see APPENDIX B-1.

### **Amendments to Bond Ordinances**

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

***Amendments of Ordinance without Consent.*** The City may, without the consent of or notice to the Owners of the Subordinate Lien Bonds, amend the Ordinance for any one or more of the following purposes: (1) to cure any ambiguity, defect, omission or inconsistent provision in the Ordinance or in the Subordinate Lien Bonds; or to comply with any applicable provision of state or federal law or regulation of federal agencies; provided, however, that such action shall not adversely affect the interests of the Owners of the Subordinate Lien Bonds; (2) to change the terms or provisions of the Ordinance to the extent necessary to prevent the interest on the Houston Airport System Bonds from being includable within the gross income of the Owners thereof for federal income tax purposes; (3) to grant to or confer upon the Owners of the Subordinate Lien Bonds any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Owners of the Subordinate Lien Bonds; (4) to add to the covenants and agreements of the City contained in the Ordinance other covenants and agreements of, or conditions or restrictions upon, the City or to surrender or eliminate any right or power reserved to or conferred upon the City in the Ordinance; (5) to subject to the lien and pledge of the Ordinance additional Net Revenues that may include revenues, properties or other collateral, (6) to add requirements or incorporate modifications the compliance with which is required by a rating agency in connection with issuing or confirming a rating with respect to any series of Houston Airport System Bonds; (7) to authorize any series of Additional Senior Lien Bonds, Additional Senior Lien Notes, Additional Subordinate Lien Bonds or Inferior Lien Bonds, and, in connection therewith: (i) to specify and determine the terms, forms and details thereof and (ii) to create such additional funds and accounts and to effect such amendments of the Ordinance that may be necessary for such issuance, provided in

each case that no such amendment or supplement shall be contrary to or inconsistent with the limitations set forth in the Ordinance; (8) to evidence any sale, transfer or encumbrance of the Houston Airport System in accordance with the Ordinance; and (9) to make any other modification, amendment or supplement that shall not materially adversely affect the interests of the Owners of the Subordinate Lien Bonds.

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

### **Houston Airport System Ordinance Amendments**

Pursuant to various ordinances authorizing outstanding Houston Airport System Bonds, the City has amended certain provisions of the ordinances authorizing all of the outstanding Houston Airport System Bonds, including the definitions of “Debt Service Requirements” and “Gross Revenues” (such amendments being collectively herein referred to herein as the “2007 Amendments” and the “2009 Amendments”) and certain provisions relating to the Subordinate Lien Bond Reserve Fund (the “2010 Amendments,” and, along with the 2007 Amendments and the 2009 Amendments, the “Amendments”). For a complete description of the Amendments, please see APPENDIX B-2. The Amendments are being ratified as part of the Ordinance, and shall be binding upon all Owners of all Houston Airport System Bonds, including the Series 2012 Bonds. The City has obtained written consent as required in each such prior ordinance and satisfied all other conditions as may be required to amend each such ordinance.

In addition, the City has determined to amend the ordinances authorizing the issuance of all of the Houston Airport System Bonds to change the definition of “Airport System” (such amendment being referred to as the “Proposed 2011 Amendment”). The Proposed 2011 Amendment changes the definition of “Airport System” to exclude Ellington Airport. Ellington Airport has no scheduled commercial flights and does not represent a significant portion of Houston Airport System operations.

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## **THE HOUSTON AIRPORT SYSTEM**

### **The Houston Airport System**

The Houston Airport System is a department of the City of Houston. It currently operates three airports: George Bush Intercontinental Airport/Houston (“Intercontinental”), William P. Hobby Airport (“Hobby”) and Ellington Airport (“Ellington”). Intercontinental is the nation’s seventh largest airport (as measured by passenger traffic in calendar year 2010) and is classified as a “large hub airport” by the FAA. It serves as a primary connecting point in the national air transportation system and is the largest operating hub for United. Hobby is the nation’s 37th largest airport (as measured by passenger traffic in calendar year 2010) and is currently used by many lower cost airlines. Southwest Airlines (“Southwest”) is Hobby’s largest scheduled passenger airline. Ellington ceased commercial passenger service in September 2004 and is currently used for general aviation, military, Coast Guard and NASA activities.

### **Effects of Recent Merger Activity on the Houston Airport System**

#### ***United/Continental Airlines***

Historically, Continental Airlines (“Continental”) has been Intercontinental’s largest provider of passenger airline services. On October 1, 2010, Continental became a wholly-owned subsidiary of United Continental Holdings, Inc. (“UCH”) as a result of the merger of a subsidiary of UCH with and into Continental (United is also a wholly-owned subsidiary of UCH.). Pursuant to the acquisition documents, UCH assumed all obligations of Continental. The combined airlines received a single operating certificate on November 30, 2011. On June 10, 2011, UCH announced that, as a result of its ongoing integration efforts, it would reduce the number of jobs in Houston by 1,500, primarily in management and clerical positions. Other published reports from Continental and United have stated, however, that the City will remain the combined airline’s largest hub. In early March 2012, the two airlines achieved full integration and began operating under the name “United Airlines.”

#### ***Southwest Airlines***

On May 2, 2011, Southwest announced that it had closed on its purchase of all of the outstanding common stock of AirTran Holdings, Inc., the parent company of AirTran Airways (“AirTran”). Pursuant to the acquisition documents, Southwest assumed all obligations of AirTran. Southwest and AirTran received approval for a single operating certificate from the FAA on March 1, 2012. Southwest will work toward full integration of AirTran over the next several years.

### **Houston Airport System Facilities**

#### ***George Bush Intercontinental Airport/Houston***

Intercontinental is situated on 10,000 acres of land approximately 22 miles north of downtown Houston. The airport opened in 1969 and is the Houston area’s largest commercial airport. Intercontinental’s facilities consist of five terminal buildings (i.e., Terminals A, B, C, D and E) with a total of 116 aircraft gates, 21 hardstand aircraft parking positions, and space for additional aircraft operations. Intercontinental has public parking for more than 21,500 automobiles in multi-story garages and surface lots, an automated underground train system connecting the five terminals and the Marriott Hotel located at Intercontinental, an above-ground level automated people mover system (“APM”) connecting all five terminals and a central federal customs and immigration inspection services building (the “Central FIS Facility”).

Terminal A contains 19 aircraft gates and seven hardstand aircraft parking positions. It is used by various airlines (including, to some extent, United) primarily for domestic aircraft operations. Terminal B, which contained 33 aircraft gates and 14 hardstand aircraft parking positions before its renovation (described below), is used principally by United as the base of its regional jet operations at Intercontinental. Terminal C, containing 29 aircraft gates, primarily serves United’s domestic mainline operations. Various airlines (including, to some extent, United) operate primarily international operations out of Terminal D, which contains 12 aircraft gates. Terminal E, containing 23 gates, is used primarily by United and accommodates most of United’s international flight operations, as well as many of United’s domestic flight operations. The Central FIS Facility is located adjacent to Terminal D and Terminal E and has the capacity to process 4,500 arriving international passengers per hour.



Intercontinental has five runways interconnected by a system of taxiways. One of the runways is 12,000 feet, two are 10,000 feet and the remaining two are at least 9,000 feet each. The runways are equipped with instrument landing systems, lighting systems, and other navigational aids and are configured to permit the simultaneous use of three runways for aircraft landings in poor visibility.

The Intercontinental complex also includes multiple air cargo buildings, fuel farms, and a consolidated rental car facility. Two fixed base operators provide airline, corporate and general aviation aircraft operations support. The Marriott Hotel is located between Terminal B and Terminal C. United and ExpressJet Airlines maintain hangar and maintenance facilities at Intercontinental.

### ***Hobby Airport***

Hobby is located on 1,500 acres approximately seven miles southeast of downtown Houston. It has one terminal building with a single concourse comprised of 25 gates and over 527,000 square feet of space. Hobby has four runways in total: two runways are over 7,600 feet, one runway is 6,000 feet and the remaining runway is almost 5,150 feet. These runways can support aircraft operations up to an Airbus A320 or Boeing B757-200.

Additional facilities include 3,750 public parking spaces, rental car facilities, an underground fuel distribution system, a cargo building, several aircraft maintenance facilities and some corporate hangars. Five fixed base operators support Hobby's significant corporate and general aviation operations. Southwest Airlines maintains a hangar at the airport.

### ***Ellington Airport***

Ellington is located approximately 15 miles southeast of downtown Houston on approximately 2,000 acres. The joint use agreement with the federal government under which it operates expired in September 2007, but is currently being held over on a month-to-month basis. It has no scheduled commercial flights and its non-governmental operations are for general aviation. NASA and the Coast Guard also currently use the airport. Ellington has three runways: one is 9,000 feet, another is 8,000 feet and the third is just over 4,600 feet.

Ellington has one fixed based operator leasing two fixed base operating facilities, approximately 90 T-hangars, and three corporate-based operators that allow it to relieve Hobby of general aviation traffic. Part of the Ellington complex is being marketed by the Houston Airport System in an effort to develop surplus land there. Lone Star Museum intends to relocate to Ellington from Galveston.

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*George Bush Intercontinental Airport/Houston*



*Hobby Airport*

## Management

The management of the Houston Airport System is the responsibility of the Director, who is appointed by the Mayor, subject to confirmation by City Council. The Director has a staff of approximately 1,500 employees. The Houston Airport System is categorized as an enterprise fund of the City, under the administrative control of the Mayor. The City Controller, as the Chief Financial Officer of the City, maintains the books of account, prepares financial statements and co-signs, with the Mayor, all warrants, contracts and orders for payment of any public funds or money relating to the Houston Airport System.

Following is selected biographical information for certain principal administrative officers and airport staff of the Houston Airport System:

**Mario C. Diaz** was appointed Director of the City of Houston Department of Aviation on May 28, 2010. He is responsible for the overall management of the Houston Airport System's three aviation facilities. Prior to his appointment as Director, beginning in 1999, Mr. Diaz served as the deputy general manager for Hartsfield-Jackson Atlanta International Airport where he was responsible for the daily operational activities of the world's busiest airport, including operations, business, finance and capital development. He has been one of the industry's leading authorities in aviation technology as well as the study of future developments in commercial aviation. Prior to 1999, Diaz was the manager of business, properties and commercial development for New Jersey Airports, a post he held for four years. In this role, he managed the division responsible for all business and lease negotiations at Newark International Airport as well as the day-to-day oversight management of Teterboro Airport, one of the nation's premier general aviation airports and a major reliever airport for Newark International. Before that, Mr. Diaz served for 17 years with the Port Authority of New York and New Jersey. Beginning in 1981, Mr. Diaz held key management positions in leasing, finance, marketing, operations and properties. During this period, Diaz also served 18 months as the assistant director of the redevelopment program at John F. Kennedy Airport. A native of Barranquitas, Puerto Rico, and a licensed private pilot with instrument certification, Diaz earned his Bachelor of Arts degree from Rutgers University in Newark, New Jersey. He also earned a Master of Business Administration in finance from Rutgers Graduate School of Business Administration in New Jersey.

**Lance Lyttle**, Chief Operating Officer, is responsible for the daily management and operation of the Houston Airport System's three aviation facilities, advising the Director of Aviation on business strategy, driving operational and performance excellence (including identifying revenue and cost reduction initiatives), ensuring achievement of long-term corporate objectives, monitoring and developing team performance, and planning by prioritizing customer, employee, and organizational requirements. Mr. Lyttle reports to the Director of Aviation. Prior to his current position, Mr. Lyttle was the Houston Airport System's Chief Development Officer. Mr. Lyttle holds a Bachelor of Science degree in Computer Science and Physics and a Master of Science degree in Management Information Systems. Overall, he has more than seventeen years' experience as an aviation executive specializing in strategic planning, business plan development and execution, information technology, and driving operational excellence.

**Eric R. Potts**, Chief Strategy and Performance Officer and Deputy Director for the Houston Airport System, was appointed Interim Director of Aviation by then Mayor Bill White and served for one year. In his current role, he is responsible for strategic and business plan development, performance technology development, information technology projects and business process. Prior to his current role, Mr. Potts served as Chief Development Officer and Deputy Director of Planning Development and Construction of the Houston Airport System. Mr. Potts also previously served as the Executive Director of the Civil Works directorate, U.S. Army Corps of Engineers, with responsibility for the coordination of staff who supervised the nationwide Civil Works activities of eight major commands. A 27-year career Army officer, Mr. Potts held a number of command and staff positions in the U.S. and Germany. His military decorations include two Legion of Merit medals, five Meritorious Service medals, two Army Commendation medals, the National Defense Service medal, and the German Silver Cross of Honor. Mr. Potts has a BS degree in civil engineering from the University of Missouri-Rolla and a Master of Arts in National Security and Strategic Studies from the Naval War College.

**Ian N. Wadsworth** is Chief Commercial Officer of the Houston Airport System and Deputy Director of Commercial Development. He oversees the commercial activities at the Houston Airport System's three airports, including air service development, airline affairs, concessions, parking, real estate and business development. He joined the Houston Airport System in November 2008 as Deputy Director, Finance and Administration. In that position, Mr. Wadsworth was responsible for the finance, properties, human resources, and procurement functions. Prior to joining the Houston Airport System, Mr. Wadsworth served in various finance, planning, and marketing roles over the past 15 years at American

Airlines, Capital One Financial, and Global Aero Logistics, the parent company of ATA Airlines, World Airways, and North American Airlines. Mr. Wadsworth received a Bachelor's degree in International Affairs from George Washington University and an MBA degree in Finance from the University of Michigan Business School.

**Kirk G. Rummel, Jr.**, is the Chief Financial Officer and Deputy Director. Mr. Rummel is responsible for capital investment funding, debt management, budgeting, accounting, and financial analysis. Mr. Rummel previously worked at Continental Airlines for 17 years in numerous finance positions, most recently as managing director of finance-operations. From 1987 to 1994, Mr. Rummel worked as a senior auditor for the Audit Bureau of Circulations. Mr. Rummel is a Certified Public Accountant and Certified Fraud Examiner, with a BS in Finance from Texas Christian University and an MBA from the University of Texas at Austin. Mr. Rummel is actively involved in and has served on various FAA-related work groups and committees relating to NextGen avionics business case analysis.

**Lisa Kent** is the Chief Information Officer for the Houston Airport System. In this capacity, Ms. Kent oversees the strategic planning, development, and support activities for a variety of technology systems and applications, and ensures alignment with overall HAS strategic priorities. In general, Ms. Kent's organization seeks to enable or enhance communications and optimize business processes for all HAS business units, tenants, and the 49 million passengers who utilize Houston's airports each year. Ms. Kent has 22 years of technology program and project management experience and 15 years in the aviation industry. She earned a Bachelor of Science degree in Electrical Engineering from the University of Tennessee.

**Saba Abashawl**, Chief External Affairs Officer and Deputy Director, is responsible for inter-governmental relations, industry and community affairs, international business development, communications, public and media relations, and special projects. Ms. Abashawl has been an executive for the City for more than 10 years. Prior to her current position, she was the Managing Director of Development, responsible for global commercial relations and development programs that ranged from air service expansion to aviation real estate marketing and promoting the City for corporate expansion and/or relocation. Ms. Abashawl is the City's lead liaison to the Department of Homeland Security, U.S. Customs and Border Protection, the U.S. Department of State, and the U.S. Department of Commerce. Under her leadership, Houston became a Model Port of Entry and was the location for testing new procedures. From 1999 to 2004, Ms. Abashawl also served as Executive Officer for the Mayor of Houston and was responsible for international business development. She directed the City's international business development strategy along with 26 institutions, establishing Houston as the permanent Secretariat of the World Energy Cities Partnership. She previously held key positions at Houston's University of St. Thomas and Rice University. She received a Masters degree in International Finance and Business and a Bachelor's degree in Marketing from the University of St. Thomas.

**Dolores B. Rodgers** is Senior Executive Officer Human Resources and Acting Deputy Director HPT. She oversees programs and tools that assist employees with accelerate organizational change, implementing employee engagement initiatives and interventions, leading right-sizing efforts and assessing staffing needs, managing relationships, services and activities related to service level agreements with the City of Houston human resources and payroll services departments. Before assuming this role, Ms. Rodgers for over 20 years was the Human Resources Director for the Houston Airports where she lead a team that provided human resources services involving talent management, employee/labor relations, payroll administration, and organizational development. She has also worked as a human resources consultant in oil and gas exploration, manufacturing, and non-profit industries. She has a Bachelor's degree in Economics and Journalism from the University of New Mexico.

**Perry J. Miller**, A.A.E., Interim General Manager for Intercontinental, is responsible for directing the day-to-day management of Intercontinental, as well as for establishing policies, procedures, guidelines and project schedules for the airport. In addition, he also coordinates the preparation, implementation and monitoring of the budget and expenditures for Intercontinental, among other duties. Prior to his current position, Mr. Miller was briefly the Acting General Manager for Intercontinental. He has held a wide range of positions, including Assistant Director of Maintenance, Airport Manager for Ellington, senior superintendent, airport properties representative, airport supervisor and management analyst. During his 20-year aviation career he has become an accredited executive of the American Association of Airport Executives. Mr. Miller obtained his Bachelor of Science degree in Airway Science-Management from Texas Southern University in 1990. He also holds a Master of Science degree in Transportation Planning and Management. Mr. Miller is a graduate of the Airport Management Professional Accreditation Program and is designated as an International Airport Professional.

**Ross Underhill** is the Interim General Manager for Hobby Airport and has primary responsibility for ensuring the airport meets or exceeds federal, state and local regulations for operational safety and security. Mr. Underhill joined the Houston Airport System in March of 1989. Mr. Underhill has held numerous positions at Hobby, including Assistant General Manager-Operations, Senior Superintendent-Operations, Airport Superintendent-Airfield and Grounds Maintenance, Airport Security Coordinator and Airport Operations Officer. In 2002, he was deployed on behalf of the Houston Airport System to Quito, Ecuador to coordinate the operational transition of Mariscal Sucre International Airport from a governmental enterprise to a private enterprise. Prior to joining the Houston Airport System in 1989, Mr. Underhill served in the United States Army for 14 years as an air traffic controller. He has a Bachelor's degree from The University of the State of New York.

**Brian Rinehart**, General Manager for Ellington, is responsible for the day-to-day operations of the facility and the development and implementation of policies and procedures. Mr. Rinehart joined the Houston Airport System in 1995 and has been assigned to Parking, Building Services, Physical Plant Maintenance and Intercontinental Management. He has attended numerous management and leadership-related courses throughout his civilian and military career, resulting in the award of several certifications. Mr. Rinehart attended Embry-Riddle Aeronautical University, receiving a Bachelor of Aviation Management and a Bachelor of Aviation Science with magna cum laude recognition. In aerial combat, Mr. Rinehart was awarded the Silver Star, Bronze Star with Oak Leaf Cluster, Distinguished Flying Cross, Purple Heart, four Air Medals for Valor and 38 Air Medals for aerial operations in combat zones.

**Michael A. Lee** serves as the Deputy Assistant Director of Financial Planning and Analysis and oversees financial planning, rates and charges and long-term planning. In August of 2007, he joined the Houston Airport System's finance department as Rates and Charges Manager and is responsible for developing the annual airline rates and charges and reconciliations. From 2002 to June 2007, Mr. Lee served on the commercial development team as an Airport Properties Representative, where he negotiated leases and managed the relationships with more than a dozen domestic and international airlines at both Intercontinental and Hobby. Mr. Lee began his career in airport management when he joined the properties department at Lambert-St. Louis International Airport (STL) in June 1998. During his time with STL, Michael assisted with the management of concessions, ground transportation and airline leases. In December of 2000, Michael was promoted to Ground Transportation Manager and managed the parking and ground transportation programs. Mr. Lee was in the first graduating class of the joint ACI/ICAO Airport Management Professional Accreditation Program, earning the International Airport Professional (I.A.P.) designation in 2008. Mr. Lee earned a Bachelor of Science in Aviation Management at the University of Central Missouri. Michael earned his aircraft dispatch certificate and was an aircraft dispatcher for Skyway Airlines in Milwaukee, Wisconsin. Mr. Lee is also an instrument-rated private pilot.

**Diane Ruscitti**, Deputy Assistant Director of Debt-Treasury Management, is responsible for overseeing the issuance and management of debt, financial risk management, capital funding and investor relations. Ms. Ruscitti joined the Houston Airport System in October 2010. Previously, Ms. Ruscitti worked at Alaska Air Group in Seattle, Washington where she oversaw a large fuel hedging program. She also worked at San Jose International Airport where she was responsible for the funding of a \$1.3 billion capital improvement program. From 1993 through 2006, Ms. Ruscitti worked at United Airlines in Chicago principally as Director, Corporate Finance. Ms. Ruscitti received a Bachelor of Science in economics, summa cum laude from the University of Illinois at Chicago and an MBA degree in Finance from Indiana University, also summa cum laude.

## **Airport Service Region**

The primary service region for the Houston Airport System is the 10-county Metropolitan Statistical Area ("MSA") of Houston-Sugar Land-Baytown and the 12-county Combined Statistical Area ("CSA") of Houston-Baytown-Huntsville. The 2010 U.S. Census population estimate for the MSA was approximately 5.95 million. The MSA and CSA contain the City of Houston, which is the nation's fourth most populous city. Harris County (the county in which the City is located) accounted for 68.8% of the MSA's population. The Houston Airport System's air service region also encompasses smaller but essential markets such as Beaumont/Port Arthur, Victoria, Brownsville and Del Rio in Texas, Lake Charles, Louisiana and many more.

# HOUSTON AIRPORT SYSTEM



	Metropolitan Statistical Area (MSA) of Houston - Sugar Land - Baytown, TX includes 10 counties.
	Consolidated Statistical Area (CSA) of Houston - Baytown - Huntsville, TX adds both Matagorda & Walker Counties



As illustrated by the following chart, the MSA's population has grown consistently over the past five years:

**Historical Houston-Sugar Land-Baytown MSA  
Population Estimates\***

<u>Year</u>	<u>Population</u>	<u>Annual Percentage Change</u>
2010	5,947,000	1.4%
2009	5,867,000	2.5
2008	5,727,000	2.3
2007	5,598,000	2.1
2006	5,485,000	3.5

\* Source: City of Houston

The development and diversity of the economic base of an airport's service region is important to airline traffic growth at the airports. This is particularly true for an economy in which the industries in the region may rely on the airports for passenger and cargo airline service. Because the region is located on the coastal plain in Southeast Texas, approximately 50 miles from the Gulf of Mexico, it is an ideal gateway to Latin America. Intercontinental is currently the third busiest U.S. international gateway to Latin America, behind only Miami and New York Kennedy airports. The region also is a center for the energy, financial, medical, transportation, retail and manufacturing industries. The City has 23 Fortune 500 companies located in its metropolitan area, behind only New York and Chicago in its number of Fortune 500 companies. Its George R. Brown Convention Center has 1.2 million square feet of meeting space and hosted 480,283 convention delegates in 2010.

**Houston Airport System Strategic Plan**

The mission of the Houston Airport System is to connect people, businesses, cultures and economies of the world to Houston. To support this mission, the Houston Airport System recently implemented a Strategic Plan consisting of four key strategic priorities designed to influence the Houston Airport System's business in upcoming years as they will help assess business unit plans, set priorities and allocate resources in support of various programs and initiatives.

As an enterprise fund of the City of Houston, the Houston Airport System establishes an annual budget and a five-year capital improvement appropriation plan, each of which is approved by City Council. The City Council must approve each individual element within the Capital Improvement Plan as well.

The four key strategic priorities are as follows:

- Strategic Priority #1: Build a high performance organization in which employees take ownership of the Houston Airport System's mission, vision and core values
- Strategic Priority #2: Increase international service
- Strategic Priority #3: Develop a solid infrastructure, maintenance, restoration and replacement program that is properly planned and sequenced
- Strategic Priority #4: Maintain a fiscally strong Houston Airport System



## Non-Airline Airport Initiatives

The Houston Airport System has undertaken a number of initiatives in recent years to increase non-airline revenues. In 2003, the City implemented the phased development of 165 acres of land at the northeast end of Intercontinental as a new cargo area. This development is in addition to the ground and facilities in place at the central cargo area. The first phase of the new development involved approximately 104 acres and provides more than half a million square feet of cargo terminal space, with parking spaces for 20 wide-body freighter aircraft. The City has leased a portion of this land to three private developers for cargo development purposes. Trammel Crow has constructed a building to be used for perishables or other cargo.

## Houston Airport System Capital Improvement Program

**General Discussion.** The Capital Improvement Program (“CIP”) is the City’s five-year comprehensive plan that determines and prioritizes the capital and infrastructure needs of the Houston Airport System. The City updates the CIP annually. The Houston Airport System undertook a major renovation, modernization and expansion project of all three airports starting in the late 1990s. Since that time, Houston Airport System projects have totaled approximately \$3.3 billion. At Intercontinental, the City built, among other projects, a fifth runway, numerous other runway and taxiway expansions and improvements and a new international arrivals facility, renovated Terminals A and C, constructed a new automated people mover system and parking facilities and expanded the central plant. At Hobby, the City substantially rebuilt the concourse and terminal and made runway and taxiway improvements. At Ellington, the City made airfield improvements. The Houston Airport System continuously monitors and adjusts the CIP based upon financial and air travel demands. See also “INVESTMENT CONSIDERATIONS.”

**Master Plans.** The Houston Airport System is in the process of updating the Master Plans at all three airports. Generally, new Master Plans are demand-driven, time-driven and tied to levels and strategic goals. Projects are implemented when a pre-defined need is reached and re-validated in the then current operating environment. The City will modify the Houston Airport System’s CIP, as appropriate, upon completion of the Master Plans for all three airport properties.

**CIP Projects.** The current five-year CIP, which covers Fiscal Year 2012 through Fiscal Year 2016 (“Fiscal Year 2012-2016 CIP”) calls for approximately \$874 million in projects. The City is in the process of updating the Fiscal Year 2012-2016 CIP for Fiscal Years 2013-2017. The major projects in the Fiscal Year 2012-2016 CIP include the following:

### Major Projects as Shown in Fiscal Year 2012-2016 CIP (dollars in thousands)

<u>Airport</u>	<u>Description</u>	<u>Amount</u>
Intercontinental	Terminal B Improvement Projects	\$ 287,850
	Terminal D Renovation and Expansion	174,929
	Runway, Taxiway and Airfield Projects	117,700
	Central Plant and Utility Renovations	56,620
	Parking Improvements	18,060
	Aircraft Operations Center	12,110
Hobby	Parking Improvements	50,850
	Federal Inspections Services Facility	4,501

**Terminal B Improvement Projects.** The City has undertaken or expects to undertake a series of Terminal B Improvement Projects at Intercontinental. While the total cost of the Houston Airport System’s share of the Terminal B Improvement Projects was expected to equal \$287.85 million at the time the Fiscal Year 2012-2016 CIP was put into place, the latest cost projection is approximately \$265.1 million. Given the most recent cost projection to the Houston Airport System, the total cost of the Terminal B Improvement Projects for both the Houston Airport System and United is expected to equal \$940.1 million. The Houston Airport System has reallocated the dollar amount associated with this capital project savings of \$22.75 million to a variety of other capital projects.

Phase I will replace the two existing South circular flight stations of Terminal B used by United with a new South Concourse building at Terminal B for United's regional jet operations at Intercontinental. Phase I is expected to be completed by November 2013 and is estimated to cost the Houston Airport System approximately \$53 million.

In connection with the Terminal B Improvement Projects, the City issued its \$113,305,000 Airport System Special Facilities Revenue Bonds (Continental Airlines, Inc. Terminal Improvement Project), Series 2011 (AMT) in November 2011 and entered into a Second Amended and Restated Special Facilities Lease Agreement (the "Amended and Restated Special Facilities Lease") with United. Pursuant to the Amended and Restated Special Facilities Lease, United is responsible for paying all debt service relating to the Series 2011 Special Facilities Bonds. The Amended and Restated Special Facilities Lease has a term of thirty years, subject to certain early termination provisions and extension provisions. Pursuant to the Amended and Restated Special Facilities Lease, the City leases to United all of Terminal B as well as certain special facilities located in Terminal C that were financed with proceeds of previously issued special facilities bonds. United may undertake future projects under the Amended and Restated Special Facilities Lease financed with future special facilities bonds issued by the City. See "HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS – Airport Use and Lease Agreements and Second Amended and Restated Special Facilities Lease Agreement – Intercontinental Terminal B Improvement Projects and Special Facilities Lease."

*Terminal D Renovation and Expansion.* Intercontinental's Terminal D opened in 1991 and is under evaluation for upgrading and replacement of building utility systems and other systems. Planned renovations include cosmetic improvements, installation of a new A380-capable passenger loading bridge, and installation of new pre-conditioned air/ground power units to allow planes parked at the gates to avoid running their auxiliary power units (APUs). Terminal D improvements include a pier to be added to the building to increase overall wide-body aircraft capacity. Pursuant to a comprehensive study of the condition of the existing Terminal D currently underway, the Houston Airport System may make additional improvements to Terminal D to accommodate international travel at Intercontinental. The final project scope will heavily influence choice of funding.

*Runway, Taxiway and Airfield Projects.* These projects relate primarily to taxiway rehabilitation or construction at Intercontinental. Rehabilitation work is undertaken based on a calculated "PCI," or pavement condition index factor, which defines the minimum threshold level of pavement strength. Rehabilitation is undertaken to avoid falling below certain pre-defined thresholds. A large portion of the cost of these projects is eligible for grant or PFC funding.

*Central Plant and Utility Renovations.* The first part of this project upgrades the central plant at Intercontinental by increasing chilled and hot water generating capacity and reducing air emissions. The project also upgrades existing electric chillers, adds solar panels and hot water heaters, and installs ultra-low nitrogen-oxide burners. This project has received Voluntary Airport Low Emissions (VALE) grant funding and PFC funding. The second part of the project upgrades sanitary sewers and public lines and is expected to be funded out of the Airports Improvement Fund.

*Aircraft Operations Center (AOC).* This project includes the construction of a new aircraft operations center at Intercontinental to handle day-to-day operations for the airports and provide a centralized and coordinated emergency center in the event of an emergency or crisis at the airport. The project also funds a backup information technology data center. The AOC may be eligible for either grant or PFC funding.

*Parking Improvements.* Structured and economy airport parking is at maximum capacity at various times of the week at Hobby. Accordingly, a second parking garage and second economy parking lot at Hobby are included in the CIP. Additionally, the Houston Airport System is reviewing other opportunities to add to its parking capacity at Intercontinental in an effort to provide additional customer service and increase market share. These projects are likely to be funded out of the Airports Improvement Fund.

*Hobby Federal Inspections Service Facility.* Southwest has asked the Houston Airport System to evaluate the feasibility of flying internationally out of Hobby. To accommodate international service at Hobby, the Houston Airport System is evaluating the need for an arrivals hall along with several departure gates. Initial indications are that the cost of such an international facility would exceed the amount included in the current CIP. As a result, the Houston Airport System is looking at a variety of different funding mechanisms.

**CIP Project Funding.** The Houston Airport System anticipates funding the Fiscal Year 2012-2016 CIP from multiple sources, including available cash in the Airports Improvement Fund (AIF) and Renewal and Replacement Fund,

entitlement and discretionary grants and awards from the FAA and the Transportation Security Administration, passenger facility charges (PFCs), commercial paper draws and bond proceeds. While the current CIP anticipates the issuance of additional bonds to finance certain capital expenditures, the timing and structure of any new bond issue is uncertain and depends upon, among other things, market considerations, the amount of cash generated internally by the Houston Airport System, the timing and scope of capital improvements relating to the Terminal B Improvement Projects and the timing and scope of capital improvements relating to facilities that accommodate international flying. The Houston Airport System currently has available cash and unspent bond proceeds which may be used to pay for a significant portion of currently planned spending. The Houston Airport System also has a \$300 million commercial paper program comprised of \$150 million in Senior Lien Notes and \$150 million of Inferior Lien Notes. The Senior Lien Notes are supported by a letter of credit issued by Bank of America, which expires in December 2013, but may be terminated at the City's option at any time. On February 21, 2012, Moody's Investors Service released an announcement that it has placed certain obligations whose ratings are based solely on support from Bank of America, including the Senior Lien Notes, under review for downgrade. There are no Senior Lien Notes currently outstanding. The Inferior Lien Notes are not supported by a credit or liquidity facility.

**Passenger Facility Charges (PFCs).** The City is authorized to impose PFCs for certain Houston Airport System improvements, subject to approval by the U.S. Department of Transportation. The PFCs are not pledged or committed to pay debt service on any Senior Lien Bonds or Subordinate Lien Bonds, including the Series 2012 Bonds. Further, PFCs are not considered Gross Revenue under the Ordinance.

On November 1, 2006, the City implemented a PFC of \$3.00 per enplaned passenger at Hobby. The City has authority to impose and use \$163,517,150 of PFCs collected at Hobby through November 1, 2017. On December 1, 2008, the City implemented a PFC of \$3.00 per enplaned passenger at Intercontinental. The City has authority to impose and use \$1,372,445,143 of PFCs collected at Intercontinental through November 1, 2027. The City is authorized to use PFCs to (a) pay debt service on outstanding bonds issued for certain completed Intercontinental projects, (b) reimburse the Houston Airport System for the unamortized cost of certain other Intercontinental projects that were originally funded from the Houston Airport System's resources, such as the AIF, (c) provide pay-as-you-go funding of the local share of the costs of certain planned future projects and (d) pay debt service on commercial paper and future bonds to finance certain projects.

As of December 31, 2011, the aggregate account balances for PFC collections were \$55,743,194 at Intercontinental and \$11,837,522 at Hobby. These funds are scheduled to be used to either pay future debt service for projects already approved by the FAA or pay the local share of capital projects approved by the FAA on a pay-as-you go basis. Historical PFC collections for the Houston Airport System are shown below.

**Houston Airport System PFC Collections  
(dollars in thousands)**

	FY 2012 July-Dec	FY 2011	FY 2010	FY 2009 <sup>(1)</sup>	FY 2008	FY 2007 <sup>(2)</sup>
Intercontinental	\$ 24,152	\$ 50,982	\$ 54,284	\$ 23,046		
Hobby	6,610	12,156	12,099	9,352	11,608	6,530
Total	\$ 30,762	\$ 63,138	\$ 66,383	\$ 32,398	\$ 11,608	\$ 6,530
Year-over-Year Change	-2.2%	-4.9%	104.9%	179.1%	77.8%	--

<sup>(1)</sup> Partial year; the City began collecting PFCs at Intercontinental on December 1, 2008.

<sup>(2)</sup> Partial year; the City began collecting PFCs at Hobby on November 1, 2006.

Source: Houston Airport System

The City's authority to impose and use PFCs at both Hobby and Intercontinental is subject to certain terms and conditions in the federal PFC authorizing legislation, the PFC regulations adopted by the FAA and specific FAA approvals applicable to the Intercontinental PFC program. If the City fails to comply with any of these requirements, the failure could reduce or terminate the City's authority to impose PFCs at one or both airports and use such PFCs to finance a portion of the CIP.

For a discussion of the treatment of PFC Revenues under the Ordinance, see APPENDIX B-1 – THE ORDINANCE – Certain Defined Terms. See “Schedule 5: Selected Financial Information” for the total amount of PFC Revenues available to pay debt service and debt service coverage ratios.

**Grants under the FAA Airport Improvement Program and Other Programs.** The City has been awarded, on behalf of the Houston Airport System, numerous grants under the FAA Airport Improvement Program (AIP), including Voluntary Airport Low Emissions (VALE) grant funding, or awards from the Transportation Security Administration (TSA). Eligible projects include runway and taxiway rehabilitation, noise mitigation, environmental impact studies and security projects. The Houston Airport System recognized capital contributions from these programs ranging from \$41.1 million to \$85.7 million over the prior five years.

### **HOUSTON AIRPORT SYSTEM OPERATING STATISTICS**

According to the Airports Council International, an airport industry group, Intercontinental and Hobby ranked 7<sup>th</sup> and 37<sup>th</sup> among U.S. airports, respectively, based on total U.S. passenger traffic for calendar year 2010.

Total passengers for the Houston Airport System increased by 1.7% to 49.8 million during Fiscal Year 2011. During this same period, total passengers at Hobby increased 7.8% to 9.4 million. Total passengers increased by 0.4% at Intercontinental, with international passenger growth up 7.3%.

Each airport has a large primary air carrier: United<sup>1</sup> at Intercontinental and Southwest at Hobby. United and its regional partners, collectively, accounted for approximately 87.4% of total passengers at Intercontinental in Fiscal Year 2011, a slight decline from 88.0% in 2010. Southwest and AirTran, together, accounted for 91.3% of all passengers at Hobby in Fiscal Year 2011, a slight decline from their 91.6% share in 2010. See “Schedule 1: Passenger Statistics” and “Schedule 2: Airline Market Shares.”

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<sup>1</sup> Continental Airlines and United Airlines merged on October 1, 2010. The two airlines received a single operating certificate from the FAA on November 30, 2011. In early March 2012, the two airlines achieved full integration and began operating under the name “United Airlines.” See “THE HOUSTON AIRPORT SYSTEM – Effects of Recent Merger Activity on the Houston Airport System – United/Continental Airlines.”

## Airlines Utilizing the Houston Airport System

The table below shows the passenger airlines that provide scheduled service as of January 2012 from either Intercontinental or Hobby. As of October 2011, the scheduled passenger airlines that serve Houston averaged 5,646 weekly aircraft departures, serving more than 120 domestic destination airports, including all major U.S. cities. The airlines also provide service to 67 international destinations, and currently serve or expect to serve cities in Mexico, Latin America, Central America, Canada, Europe, Asia, Middle East, Australia and Africa. Except for Alaska Airlines at Intercontinental and JetBlue and Frontier at Hobby, all of the carriers shown below have signatory airline status under various use and lease agreements.

Intercontinental			Hobby
Mainline Carriers	Regional Carriers	Cargo Carriers	Passenger Carriers
AeroMexico	American Eagle	Air France	AirTran
Air France	Atlantic Southeast	Atlas Air	American Eagle
Alaska Airlines	Chautauqua	BAX Global	Atlantic Southeast
American Airlines	Colgan	CargoLux	Comair
British Airways	Comair	Cathay Pacific	Compass
Delta	Compass	China Airlines Cargo	Delta
Emirates	ExpressJet	DHL	Frontier
Jazz Air	Mesa	Eva	JetBlue
KLM	Mesaba	Federal Express	Pinnacle
Lufthansa	Pinnacle	Global Supply	Shuttle America
Qatar	Republic	Martinaire	Skywest
Singapore	Shuttle America	Lufthansa Cargo	Southwest
TACA	SkyWest	Saudi Arabian Airlines	
United (Continental)		UPS	
US Airways			
Viva Aerobus			
Atlas Air (for Angola, formerly World)			

Source: Houston Airport System

**United Airlines.** United is the largest airline operator at Intercontinental, with combined average daily departures of 606 for calendar year 2011, including both carriers' regional jet or Express partners. United, including Continental, and its regional partners carried 87.4% of total passengers in Fiscal Year 2011, 88.0% of total passengers in Fiscal Year 2010 and 88.5% of total passengers in Fiscal Year 2009. See "THE HOUSTON AIRPORT SYSTEM – Effects of Recent Merger Activity on the Houston Airport System – United/Continental Airlines" and "Schedule 2: Airline Market Shares." For a discussion of the sources of operating revenues for the Houston Airport System, and the term of United's use and lease agreement at Intercontinental, respectively, see "HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION – Sources of Revenues" and "HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS – Airport Use and Lease Agreements and Second Amended and Restated Special Facilities Lease Agreement" and "– Intercontinental Terminal E Lease and Special Facilities Lease Agreement."

**Southwest Airlines.** Southwest is the largest operator at Hobby with 122 average daily departures for calendar year 2011. Southwest acquired AirTran in May 2011, and the two airlines received approval for a single operating certificate from the FAA on March 1, 2012. On a combined basis, Southwest and AirTran carried 91.3% of traffic in Fiscal Year 2011, 91.6% of traffic in Fiscal Year 2010 and 92.0% of traffic in Fiscal Year 2009. See "THE HOUSTON AIRPORT SYSTEM – Effects of Recent Merger Activity on the Houston Airport System – United/Continental Airlines."

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

**Schedule 1: Passenger Statistics**

Schedule 1 shows total passengers at Intercontinental and Hobby over the most recent five fiscal years and the first six months of FY 2012. Intercontinental has seen significant growth in international passengers, but a decline in the number of domestic passengers during this period. Hobby has seen growth over the five-year period in total.

**Houston Airport System  
Total Passengers  
(in thousands)**

<b>Intercontinental Domestic Passengers</b>	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
Enplanements and Deplanements	16,196	31,666	32,093	31,995	35,200	35,260
Year-over-Year Change	-0.9%	-1.3%	0.3%	-9.1%	-0.2%	3.4%
<b>Intercontinental International Passengers</b>						
Enplanements and Deplanements	4,272	8,732	8,138	7,642	7,976	7,555
Year-over-Year Change	-2.1%	7.3%	6.5%	-4.2%	5.6%	6.0%
<b>Total Intercontinental Passengers*</b>						
Enplanements and Deplanements	20,468	40,399	40,231	39,637	43,176	42,815
Year-over-Year Change	-1.2%	0.4%	1.5%	-8.2%	0.8%	3.8%
<b>Hobby Passengers</b>						
Enplanements and Deplanements	5,092	9,434	8,755	8,286	9,097	8,642
Year-over-Year Change	8.7%	7.8%	5.7%	-8.9%	5.3%	2.6%
<b>Total Airport System Passengers*</b>						
Enplanements and Deplanements	25,560	49,833	48,986	47,923	52,274	51,457
Year-over-Year Change	0.7%	1.7%	2.2%	-8.3%	1.6%	3.6%

Source: Houston Airport System

\*Numbers may not total exactly due to rounding.

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**Schedule 1A: Total Enplaned Passengers for the Houston Airport System**

Schedule 1A shows the originating and connecting enplanements for Intercontinental and Hobby over the most recent five fiscal years and the first six months of FY 2012. The percentage of originating enplanements has generally stayed within a relatively narrow range for both airports.

**Houston Airport System  
Total Originating and Connecting Enplaned Passengers  
(in thousands)**

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
<b>Intercontinental</b>						
Originating Enplanements	4,999	9,697	9,279	9,191	10,450	10,478
Connecting Enplanements	5,167	10,509	10,855	10,681	11,191	11,009
Total Enplanements*	10,166	20,206	20,134	19,872	21,640	21,487
Originating Enplanement Percentage	49.2%	48.0%	46.1%	46.3%	48.3%	48.8%
<b>Hobby</b>						
Originating Enplanements	1,965	3,618	3,343	3,323	3,606	3,396
Connecting Enplanements	588	1,122	1,054	836	957	948
Total Enplanements*	2,553	4,739	4,397	4,159	4,562	4,344
Originating Enplanement Percentage	77.0%	76.3%	76.0%	79.9%	79.0%	78.2%
<b>Houston Airport System</b>						
Originating Enplanements	6,964	13,315	12,622	12,513	14,055	13,874
Connecting Enplanements	5,755	11,630	11,909	11,517	12,147	11,956
Total Enplanements*	12,718	24,945	24,531	24,031	26,202	25,830
Originating Enplanement Percentage	54.8%	53.4%	51.5%	52.1%	53.6%	53.7%

Source: Houston Airport System

\*Numbers may not total exactly due to rounding.

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## Schedule 2: Airline Market Shares

Schedule 2 shows airline market shares for the Houston Airport System over the most recent five fiscal years and the first six months of FY 2012. United and Southwest continue to provide most of the traffic at Intercontinental and Hobby, respectively.

### Houston Airport System Market Share Data (in thousands)

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
<b>Total Passengers-Intercontinental</b>						
<b>Domestic</b>						
United/Continental and affiliates	14,435	28,365	28,793	28,833	31,880	32,088
Delta Airlines and affiliates	597	1,177	1,228	1,234	1,271	1,221
US Airways and affiliates	571	1,046	939	858	790	437
American and affiliates	514	891	836	857	995	1,009
All Other Airlines	80	187	297	213	264	506
Subtotal Domestic Passengers*	16,197	31,666	32,093	31,995	35,200	35,260
<b>International</b>						
United/Continental and affiliates	3,325	6,945	6,595	6,255	6,524	6,152
Air Canada/Jazz	118	233	189	172	196	178
British Airways	127	245	221	208	208	212
Emirates	130	221	163	148	80	-
Lufthansa	105	212	196	179	199	177
AeroMexico	89	192	138	115	159	187
Air France	77	147	163	203	245	251
Qatar	75	146	136	33	-	-
KLM	98	179	177	184	202	202
Singapore	63	117	81	59	15	-
All Others	64	95	79	88	148	197
Subtotal Int'l Passengers*	4,272	8,732	8,138	7,642	7,976	7,555
<b>Total (Domestic and International)*</b>	<b>20,469</b>	<b>40,399</b>	<b>40,232</b>	<b>39,638</b>	<b>43,176</b>	<b>42,815</b>
<b>Market Share-Intercontinental</b>						
<b>Domestic</b>						
United/Continental and affiliates	70.5%	70.2%	71.6%	72.7%	73.8%	74.9%
Delta Airlines and affiliates	2.9	2.9	3.1	3.1	2.9	2.9
US Airways and affiliates	2.8	2.6	2.3	2.2	1.8	1.0
American and affiliates	2.5	2.2	2.1	2.2	2.3	2.4
All Other Airlines	0.4	0.5	0.7	0.5	0.6	1.2
Subtotal Domestic	79.1%	78.4%	79.8%	80.7%	81.5%	82.4%
<b>International</b>						
United/Continental and affiliates	16.2%	17.2%	16.4%	15.8%	15.1%	14.4%
Air Canada/Jazz	0.6	0.6	0.5	0.4	0.5	0.4
British Airways	0.6	0.6	0.5	0.5	0.5	0.5
Emirates	0.6	0.5	0.4	0.4	0.2	0.0
Lufthansa	0.5	0.5	0.5	0.5	0.5	0.4
AeroMexico	0.4	0.5	0.3	0.3	0.4	0.4
Air France	0.4	0.4	0.4	0.5	0.6	0.6
Qatar	0.4	0.4	0.3	0.1	0.0	0.0
KLM	0.5	0.4	0.4	0.5	0.5	0.5
Singapore	0.3	0.3	0.2	0.1	0.0	0.0
All Others	0.3	0.2	0.2	0.2	0.3	0.5
Subtotal International	20.9%	21.6%	20.2%	19.3%	18.5%	17.6%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>



**Houston Airport System  
Market Share Data  
(in thousands)  
(cont'd)**

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
<b>Total Passengers-Hobby</b>						
Southwest/AirTran	4,579	8,610	8,022	7,622	8,437	7,841
Delta Airlines and Affiliates	196	335	308	285	297	276
American Eagle	106	207	265	234	191	223
JetBlue	80	141	150	140	168	157
Frontier	121	123	0	0	0	0
All Others	10	18	9	5	4	144
Total*	<u>5,092</u>	<u>9,434</u>	<u>8,755</u>	<u>8,286</u>	<u>9,097</u>	<u>8,642</u>
<b>Market Share-Hobby</b>						
Southwest/AirTran	89.9%	91.3%	91.6%	92.0%	92.7%	90.7%
Delta Airlines and Affiliates	3.9	3.6	3.5	3.4	3.3	3.2
American Eagle	2.1	2.2	3.0	2.8	2.1	2.6
JetBlue	1.6	1.5	1.7	1.7	1.8	1.8
Frontier	2.4	1.3	0.0	0.0	0.0	0.0
All Others	0.2	0.2	0.1	0.1	0.0	1.7
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Source: Houston Airport System

\*Numbers may not total exactly due to rounding.

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**Schedule 3: Total Aircraft Operations and Aircraft Landed Weight**

Schedule 3 shows the aircraft operations (take-offs and landings) and aircraft landed weight for the Houston Airport System for the most recent five fiscal years and the first six months of FY 2012.

**Aircraft Operations  
(in thousands)**

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
Aircraft Operations	423	861	858	892	974	983
Year-over-Year Change	-1.4%	0.3%	-3.8%	-8.4%	-0.9%	5.4%

**Aircraft Landed Weight  
(in million pounds)**

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
Aircraft Landed Weight	16,590	32,564	31,662	31,907	34,096	33,930
Year-over-Year Change	1.9%	2.8%	-0.8%	-6.4%	0.5%	3.4%

Source: Houston Airport System

**Schedule 4: Total System Cargo Activity**

Schedule 4 shows cargo activity for the Houston Airport System for the most recent five fiscal years and the first six months of FY 2012. Two airlines began cargo service out of Intercontinental in calendar year 2011: Lufthansa Cargo in April and Qatar Cargo in November. Also in Fiscal Year 2012, CargoLux added new service to Lagos, Nigeria and Saudi Arabian Airlines Cargo, China Airlines and Cathay Pacific Cargo each added additional frequencies to their existing service.

**Total System Cargo Activity  
(in metric tons)**

	Jul-Dec FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007
Domestic Freight	104,471	205,174	195,617	186,085	210,532	207,763
International Freight	109,464	208,748	181,453	164,790	181,091	170,972
Mail	17,041	33,897	37,011	36,082	34,957	43,470
Total Cargo	230,977	447,818	414,081	386,958	426,580	422,205
Year-over-Year Change	4.1%	8.1%	-7.5%	-6.6%	10.2%	-1.0%

Source: Houston Airport System

\*Numbers may not total exactly due to rounding.

## HOUSTON AIRPORT SYSTEM FINANCIAL INFORMATION

### Sources of Revenues

The Houston Airport System generates Operating and Non-Operating Revenues from various sources:

**Landing Fees.** Landing fees for airlines that provide scheduled service at Intercontinental and Hobby are computed under formulas derived from various use and lease agreements and license agreements (see “HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS – Airport Use and Lease Agreements and Second Amended and Restated Special Facilities Lease Agreement”). Landing fees are also applied by ordinance to nonscheduled, commercial aircraft and nonsignatory scheduled aircraft landings at both airports based upon maximum FAA-approved gross landed weights. In addition, the City receives revenues from aviation fuel flowage fees (currently six cents per gallon) assessed on the delivery of fuel to certain aircraft in lieu of landing fees.

**Building and Ground Area Revenues.** Terminal space rentals paid by signatory airlines under use and lease agreements are subject to annual compensatory adjustment depending upon additional capital improvements, maintenance, operating and overhead expenses allocable to the facilities. Ground rentals are charged by the City under long-term ground leases of land at Intercontinental, Hobby, and Ellington. The City leases various parcels of land to airlines, fixed base operators and various corporations for hangars, aircraft maintenance facilities, flight kitchens and cargo buildings, auto rental companies for their service facilities and storage lots, and to a variety of other entities for buildings and other permanent improvements.

**Parking, Concessions, and Other Revenues.** City-owned parking facilities are the largest single source of revenues of the Houston Airport System other than payments by the airlines. Parking operations are managed and operated by New South Parking pursuant to a concession agreement with the Houston Airport System. See “HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS – Other Significant Airport Agreements.” Parking rates are approved by the City Council of the City.

**PFCs.** The Houston Airport System derives a significant source of non-operating revenues from PFC collections which are authorized for both Intercontinental and Hobby. While the Ordinance does not define Gross Revenues (as defined under the Ordinance) to include PFCs, they are recognized as non-operating revenues in the Houston Airport System’s comprehensive annual financial statements. Beginning in Fiscal Year 2010, the Houston Airport System switched to accrual accounting from the cash basis for PFCs.

Funds must be generated primarily from parking, concessions and other airport revenues in order to (1) cover the Houston Airport System’s operating expenses and depreciation expense (or that portion not paid for by airlines); (2) produce a surplus to meet current or anticipated needs of the Houston Airport System, and (3) comply with the Rate Covenant.

### Schedule 5: Selected Financial Information

Schedule 5 sets forth, for the Fiscal Years indicated, (1) the Gross Revenues, Operation and Maintenance Expenses and Net Revenues (each computed as defined in the Ordinance) of the Houston Airport System, (2) the total Debt Service Requirement (computed as defined in the Ordinance) on then outstanding Houston Airport System Bonds, which include all obligations payable from revenues of the Houston Airport System and (3) the coverage of Debt Service Requirement by Net Revenues. All amounts in “Schedule 5: Selected Financial Information” for Fiscal Years 2007 through 2011 are derived from the financial statements of the Houston Airport System Fund, or from the supplementary information and the statistical section included in the City Controller’s Comprehensive Annual Financial Report of the City of Houston, Texas, for each respective Fiscal Year. Interim results as of December 31, 2010 and December 31, 2011 were derived from internal accounting information of the City. The schedule should be read in conjunction with the complete audited financial statements of the City of Houston, Texas, Airport System Fund Comprehensive Annual Financial Report and the notes thereto included as APPENDIX A.

(dollars in thousands)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	July-Dec 2010 (6 months) <sup>(5)</sup>	July-Dec 2011 (6 months) <sup>(5)</sup>
<b>Operating Revenues</b>							
Landing fees:							
Landing fees	\$ 88,933	\$ 95,730	\$ 80,420	\$ 91,032	\$ 87,163	\$ 43,236	\$ 42,924
Aviation fuel	1,540	1,522	1,313	1,329	1,378	654	663
Aircraft parking	1,667	1,765	1,090	1,804	1,843	931	1,266
Subtotal	92,140	99,017	82,823	94,165	90,384	44,821	44,853
Building and ground area revenues:							
Terminal space	182,113	193,375	155,396	161,960	160,563	79,884	84,291
Cargo building	2,011	2,469	2,374	2,490	2,511	1,258	1,241
Other rentals	5,037	5,054	5,017	5,158	5,067	2,542	3,353
Hangar rental	3,394	3,473	4,051	4,920	5,446	2,620	2,794
Ground rental	7,165	7,415	7,595	7,577	7,595	3,846	4,030
Subtotal	199,720	211,786	174,433	182,105	181,182	90,150	95,709
Parking, concession and other revenues:							
Retail concessions	26,953	29,435	27,004	27,975	34,403	15,996	17,903
Auto parking	65,454	72,958	66,565	70,127	70,681	36,098	37,198
Auto rental	22,950	24,529	24,389	22,889	23,932	11,192	12,471
Ground transportation	4,617	4,806	4,724	4,987	5,946	2,787	3,046
Other operating revenue	4,304	4,645	5,819	4,331	3,874	2,086	1,995
Subtotal	124,278	136,373	128,501	130,309	138,836	68,159	72,613
<b>Total operating revenue</b>	<b>\$ 416,138</b>	<b>\$ 447,176</b>	<b>\$ 385,757</b>	<b>\$ 406,579</b>	<b>\$ 410,402</b>	<b>\$203,130</b>	<b>\$ 213,175</b>
<b>Nonoperating revenues</b> <sup>(1)</sup>							
Interest on investments <sup>(1)</sup>	26,847	30,064	23,664	15,988	12,889	6,816	5,248
Other revenues - revenue fund	310	90	300	2,504	341	11	7
Subtotal	27,157	30,154	23,964	18,492	13,230	6,827	5,255
<b>Total gross revenues</b>	<b>\$ 443,295</b>	<b>\$ 477,330</b>	<b>\$ 409,721</b>	<b>\$ 425,071</b>	<b>\$ 423,632</b>	<b>\$ 209,957</b>	<b>\$ 218,430</b>
<b>Operation and maintenance expenses</b> <sup>(2)</sup>							
Personnel and other current expenses	\$ 214,611	\$ 229,551	\$ 240,685	\$ 245,041	\$ 262,561	\$ 115,872	\$ 118,995
Retiree health and life insurance liability <sup>(2)</sup>	-	(11,356)	-	-	-	-	-
Interest on pension bonds and note <sup>(3)</sup>	3,064	3,064	1,711	106	106	53	53
Other interest	45	50	53	-	1	-	-
<b>Total operation and maintenance expenses</b>	<b>\$ 217,720</b>	<b>\$ 221,309</b>	<b>\$ 242,449</b>	<b>\$ 245,147</b>	<b>\$ 262,668</b>	<b>\$ 115,925</b>	<b>\$119,048</b>
<b>Net revenue</b>	<b>\$ 225,575</b>	<b>\$ 256,021</b>	<b>\$ 167,272</b>	<b>\$ 179,924</b>	<b>\$ 160,964</b>	<b>\$ 94,032</b>	<b>\$ 99,382</b>
<b>Total debt service requirements</b>	<b>\$ 144,211</b>	<b>\$ 157,302</b>	<b>\$ 150,514</b>	<b>\$ 145,467</b>	<b>\$ 158,841</b>		
PFC revenue available for debt service	(1,261)	(2,690)	(16,128)	(27,087)	(38,828)		
Grant revenue available for debt service	(19,418)	(25,332)	(38,835)	(29,084)	(17,999)		
<b>Net debt service requirement</b> <sup>(4)</sup>	<b>\$ 123,532</b>	<b>\$ 129,280</b>	<b>\$ 95,551</b>	<b>\$ 89,296</b>	<b>\$ 102,014</b>		
<b>Coverage of debt service</b>	<b>1.83</b>	<b>1.98</b>	<b>1.75</b>	<b>2.01</b>	<b>1.58</b>		

<sup>(1)</sup> The figures shown have been adjusted for miscellaneous revenues not defined as Gross Revenues or Net Revenues in the Ordinance. Excludes interest revenue earned in restricted bond and passenger facility charge funds.

<sup>(2)</sup> Does not include depreciation expenses. The liability for other post-employment benefits was not included in debt coverage before FY 2009.

<sup>(3)</sup> Portion of debt of the City of Houston allocated to the Houston Airport System.

<sup>(4)</sup> Does not include debt service for which interest was capitalized from bond proceeds. Interest earned in reserve funds and used for debt service reduces the debt service requirement. See definitions of "Debt Service Requirements" in APPENDIX B-1.

<sup>(5)</sup> Results do not comply with the reporting requirements of the Governmental Accounting Standards Board (GASB), which establishes generally accepted accounting principles for governmental entities. Compensated absences, net pension obligations and other post-employment benefits are provided only at the end of each Fiscal Year. As a result, they are not included in the operation and maintenance expenses shown above.

Source: Houston Airport System

**July-December FY 2012 versus July-December FY 2011.** For the first six months of FY 2012, Gross Revenues increased \$8.5 million (4.0%) due to higher terminal rentals and other revenues. Other revenues are higher principally due to higher volumes and new advertising revenues. Auto rental and ground transportation revenues are up due to rate increases as well. Operation and maintenance expenses increased \$3.1 million (2.7%) due to higher service contract expenses.

**FY 2011 versus FY 2010.** In FY 2011, operating revenues of \$410.4 million increased \$3.8 million or 0.9% compared to FY 2010. The increase was largely due to \$8.5 million higher advertising revenues (in concessions) and volume-driven increases in other areas. Landing fees and rentals declined by \$4.7 million due primarily to prior period adjustments in FY 2010. Interest revenues fell \$3.1 million (19.3%) due to lower interest revenues earned on cash balances. Other non-operating revenues declined \$2.2 million primarily due to the impact of prior period adjustments in FY 2010. In total, gross revenues decreased \$1.4 million.

Year-over-year operation and maintenance expenses increased \$17.5 million (7.1%). Wages and benefits were \$2.2 million higher mostly due to salary increases. Building maintenance, police and fire expenses were \$7.4 million higher primarily due to new service contracts or the effect of salary increases (police and fire are City employees). The remaining amount of the increase was caused by misclassification of prior period operation and maintenance expenses, which were originally recorded as work-in-process construction-related assets to be capitalized when assets were placed into service. Net revenues fell \$19.0 million (10.5%) year-over-year.

Total debt service requirements increased by \$13.4 million due to lower capitalized interest. Total PFCs and grants available to pay debt service increased slightly (\$0.7 million) as higher PFCs available to pay debt service more than offset lower FAA grants (end of LOI program). Net debt service of \$102.0 million increased by \$12.7 million.

**FY 2010 versus FY 2009.** In FY 2010 operating revenues increased by \$20.8 million (5.4%). The increase was due in significant part to an increase in parking rates and to a prior period adjustment that decreased Fiscal Year 2009 revenues relating to landing fees and terminal rental fees. Non-operating revenues fell by \$5.5 million due to lower interest revenues earned on cash balances.

Year-over-year operation and maintenance expenses increased by \$2.7 million (1.1%) in part due to increased salary expenses. As a result of gross revenues increasing more than operation and maintenance expenses, net revenues increased by \$12.7 million (7.6%).

Total debt service requirements fell by \$5.0 million (3.4%) as lower interest expense on variable rate debt was significantly offset by increased interest expense associated with new projects financed and placed into service in 2009. Grants and PFC Revenues available to pay debt service increased by \$1.2 million as more PFCs were applied to debt service. The net debt service requirement fell \$6.3 million (6.5%) to \$89.3 million.

**FY 2009 versus FY 2008.** In FY 2009, operating revenues decreased by \$61.4 million caused by the impact of a large negative rates and charges adjustment of \$27.6 million relating back to FY 2007 and 2008. The decrease was also due to the implementation of the PFC program at Intercontinental, which removed certain revenues from the airline rate base. Parking, concession and other revenues in FY 2009 decreased by \$7.9 million, due to the decreased passenger volume caused by the economic downturn. Interest on investments in FY 2009 decreased by \$6.4 million, due to lower cash balances. In total, gross revenues fell by \$67.6 million.

Operation and maintenance expenses in FY 2009 increased by \$21.1 million, primarily due to higher salary increases and a change to accrual accounting from cash basis for certain post-employment benefits, and higher costs for electricity and natural gas. In total, net revenues fell by \$88.7 million.

Total debt service requirements decreased in FY 2009 by \$6.8 million. Grants and PFCs available to pay debt service increased by \$26.9 million due to higher grant revenues and the implementation of a \$3.00 PFC at Intercontinental on January 1, 2009. In total, the net debt service requirement fell by \$33.7 million.

**Schedule 6: Summary of Certain Fees and Charges**

Schedule 6 shows the rates and charges for Fiscal Year 2011 and Fiscal Year 2012 for both Intercontinental and Hobby. These rates and charges are established according to the terms of the use and lease agreements for each airport and are subject to annual fiscal year-end adjustments once actual airport-related expenses are finalized.

	<b>Intercontinental</b>		<b>Hobby</b>	
	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2011</u>	<u>FY 2012</u>
Landing Fee Rates <sup>(1)</sup>	\$2.790	\$2.769	\$2.094	\$2.018
Terminal Space Rentals <sup>(2)</sup>	\$22.13 – \$80.64	\$23.30 - \$81.45	\$96.79 – \$99.29	\$94.72 - \$97.22
Apron <sup>(2)</sup>	\$2.006 – \$2.775	\$1.875 - \$2.548	\$1.867	\$1.900
Aircraft Parking (per day) <sup>(3)</sup>	\$70.00– \$300.00	\$100.00-\$400.00	\$70.00– \$300.00	\$100.00-\$400.00
Cargo (per day) <sup>(4)</sup>	\$125.00-\$450.00	\$200.00-\$600.00	\$125.00 - \$450.00	\$200.00-\$600.00
Parking Rates (maximum per day)				
Economy (Ecopark)				
Covered	\$7.00	\$7.00		
Uncovered	\$5.00	\$5.00		
Ecopark 1			\$8.00	\$8.00
Ecopark 2			\$6.00	\$6.00
Structured	\$17.00	\$17.00	\$17.00	\$17.00
Short-Term	--	--	--	--
Sure Park	\$20.00	\$20.00	--	--

<sup>(1)</sup> Per 1,000 pounds of landed weight.

<sup>(2)</sup> Range per square foot.

<sup>(3)</sup> Daily aircraft parking rates increased on August 1, 2011 at Intercontinental and Hobby to a range of \$100 - \$400.

<sup>(4)</sup> Daily cargo rates increased on August 1, 2011 at Intercontinental and Hobby to a range of \$200 - \$600.

Source: Houston Airport System

Shown below are costs per enplanement for the most recent five fiscal years for each of Intercontinental and Hobby. The airline charges for FY 2011 are estimates which will be recalculated during the rates and charges reconciliation process.

**Houston Airport System  
Total Cost Per Enplanement**

	<u>FY 2011*</u>	<u>FY 2010</u>	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>
Intercontinental	\$ 10.42	\$ 10.52	\$ 11.53	\$ 11.03	\$ 10.56
Hobby	7.99	8.75	8.64	7.79	7.83

\* Budget estimate

Source: Houston Airport System

## DEBT SERVICE REQUIREMENTS OF HOUSTON AIRPORT SYSTEM BONDS

### Schedule 7: Houston Airport System Debt Service Requirements Schedule

Schedule 7 sets forth the Debt Service Requirements, computed as defined in APPENDIX B-1, on all Outstanding Houston Airport System Obligations (including Inferior Lien Obligations), assuming scheduled mandatory redemption of any term bonds. This schedule includes the Series 2012 Bonds and excludes the Refunded Bonds and commercial paper notes.

Period Ending	Senior Lien Debt Service <sup>(1)</sup>	Subordinate Lien Debt Service <sup>(2)</sup>	Total Bonds Debt Service	Inferior Lien Obligations <sup>(d)</sup>	Bonds plus Inferior Lien Obligations
7/1/2012	\$ 17,454,880	\$ 147,467,442	\$ 164,922,322	\$ 6,583,250	\$ 171,505,572
7/1/2013	21,786,126	148,174,292	169,960,418	6,586,325	176,546,743
7/1/2014	23,818,994	148,165,067	171,984,061	6,584,125	178,568,186
7/1/2015	33,093,994	148,165,314	181,259,308	6,581,800	187,841,108
7/1/2016	33,095,244	147,970,725	181,065,969	6,583,525	187,649,494
7/1/2017	33,093,244	147,907,542	181,000,786	6,583,200	187,583,986
7/1/2018	33,091,994	148,040,558	181,132,552		181,132,552
7/1/2019	33,095,244	148,020,093	181,115,337		181,115,337
7/1/2020	33,091,494	148,023,477	181,114,971		181,114,971
7/1/2021	33,094,744	148,359,773	181,454,517		181,454,517
7/1/2022	33,093,244	148,689,306	181,782,550		181,782,550
7/1/2023	33,095,744	147,839,339	180,935,083		180,935,083
7/1/2024	33,095,494	147,854,278	180,949,772		180,949,772
7/1/2025	33,095,994	147,332,514	180,428,508		180,428,508
7/1/2026	33,095,494	149,653,613	182,749,107		182,749,107
7/1/2027	33,092,244	147,224,587	180,316,831		180,316,831
7/1/2028	33,093,675	146,918,548	180,012,223		180,012,223
7/1/2029	33,091,288	148,728,602	181,819,890		181,819,890
7/1/2030	33,095,025	148,657,521	181,752,546		181,752,546
7/1/2031	33,094,400	145,465,192	178,559,592		178,559,592
7/1/2032	33,095,200	149,193,527	182,288,727		182,288,727
7/1/2033	33,094,125	--	33,094,125		33,094,125
7/1/2034	33,092,875	--	33,092,875		33,092,875
7/1/2035	33,092,875	--	33,092,875		33,092,875
7/1/2036	33,095,275	--	33,095,275		33,095,275
7/1/2037	33,095,950	--	33,095,950		33,095,950
7/1/2038	33,095,775	--	33,095,775		33,095,775
7/1/2039	33,095,350	--	33,095,350		33,095,350
	\$ 890,415,985	\$ 3,107,851,310	\$ 3,998,267,295	\$ 39,502,225	\$ 4,037,769,520

<sup>(1)</sup> Net of capitalized interest amounts.

<sup>(2)</sup> Variable and auction rate bonds reflected at original certified rate. Actual rates will vary. See footnote (2) to "Schedule 8: Houston Airport System Outstanding Debt."

<sup>(3)</sup> Represents Houston Airport System's assumption of debt service payments for Series 1997A Special Facility Bonds under sublease with Continental (now United). See footnote (4) to "Schedule 8: Houston Airport System Outstanding Debt."

Source: Houston Airport System

## Schedule 8: Houston Airport System Outstanding Debt

Schedule 8 summarizes Houston Airport System debt outstanding as of December 31, 2011, including commercial paper notes, and adjusted to include the Series 2012 Bonds and exclude the Refunded Bonds.

	Outstanding Principal Amount (dollars in thousands)
Senior Lien Revenue Bonds, fixed rate	\$ 449,660
Senior Lien Notes <sup>(1)</sup>	-0-
Subordinate Lien Revenue Bonds, fixed rate	1,473,615
Subordinate Lien Revenue Bonds, periodic auction rate <sup>(2)</sup>	314,325
Subordinate Lien Revenue Bonds, variable rate	93,630
Inferior Lien Obligations <sup>(3)(4)</sup>	32,895
Pension Obligations Bonds <sup>(5)</sup>	<u>2,006</u>
Total Outstanding Principal	<u>\$ 2,366,131</u>
Special Facilities Revenue Bonds <sup>(4)(6)</sup>	<u>\$ 680,740</u>

<sup>(1)</sup> The City has authorized issuance of up to \$150 million of Airport System Senior Lien Notes, Series A and B, none of which are outstanding but which may be issued from time to time.

<sup>(2)</sup> Reflects the principal amounts of the Series 2000P-1, 2000P-2, 2002C, 2002D-1, and 2002D-2 auction rate bonds. The auction rate bonds are not short term/demand obligations as defined in the bond ordinances authorizing the issuance of the Houston Airport System Bonds. The City has no current plans to refund the periodic auction rate bonds.

<sup>(3)</sup> The City has authorized issuance of up to \$150 million of Airport System Inferior Lien Commercial Paper Notes, Series C, none of which are outstanding.

<sup>(4)</sup> Under a sublease from Continental (now United) to the City of the Automated People Mover originally financed with the Series 1997A Special Facilities Bonds, the City has agreed to make sublease payments that include amounts equal to the debt service on such bonds. Such payments are payable from Houston Airport System Net Revenues on the same priority as Inferior Lien Obligations. Accordingly, for purposes of this schedule, the Series 1997A Special Facilities Bonds are listed as Inferior Lien Obligations rather than as Special Facilities Bonds, even though they currently remain outstanding as Special Facilities Bonds.

<sup>(5)</sup> Represents the Houston Airport System's allocation of the City's pension obligation bonds.

<sup>(6)</sup> Represents the dollar amount of special facility revenue bonds that the City issued on behalf of third parties, the repayment of which is solely the obligation of such third party. THESE BONDS ARE SECURED SOLELY BY LEASE PAYMENTS OF THIRD PARTIES, AND NO REVENUES OF THE HOUSTON AIRPORT SYSTEM ARE PLEDGED TO PAY SPECIAL FACILITY BONDS. Approximately \$115 million of the bonds outstanding were issued to support a consolidated rental car facility and the remaining bonds were issued to support certain Continental (now United) airport terminal projects. The amount of this conduit debt obligation has been reduced by \$32.9 million to take into account the sublease that effectively transferred the debt obligation referenced in footnote 4 to the Houston Airport System.

Source: Houston Airport System

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## Schedule 8A: Cash and Liquidity

Schedule 8A shows the cash position of the Houston Airport System and a calculation of days of cash on hand. A portion of the Houston Airport System cash is restricted to certain uses and some of the cash is unrestricted. The Ordinance requires the Houston Airport System to set aside two months of operation and maintenance reserves. The Houston Airport System's policy has been to reserve greater than the minimum two month requirement to accommodate fluctuations in revenues and enplanements.

### Houston Airport System Cash and Investments (dollars in thousands)

	<u>FY 2011</u>	<u>FY 2010</u>	<u>FY 2009</u>	<u>FY 2008</u>	<u>FY 2007</u>
Total Airport System Cash and Investments	\$1,034,956	\$1,025,649	\$774,025	\$836,259	\$729,102
Days of Cash on Hand	644	693	300	707	680

Source: Houston Airport System

## HOUSTON AIRPORT SYSTEM SIGNIFICANT CONTRACTUAL AGREEMENTS

### Airport Use and Lease Agreements and Second Amended and Restated Special Facilities Lease Agreement

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

The following sections summarize the major provisions of the Houston Airport System's use and lease agreements, special facilities leases and license agreements.

**Intercontinental Terminal A Airlines Use and Lease Agreement.** The Terminal A Use and Lease Agreement expired on June 30, 2005. The expired agreement was similar to the Terminal C Use and Lease Agreement (see below) with respect to rates and charges methodology, but differs with respect to term, facility management and certain cost provisions. The Terminal A Use and Lease Agreement is currently being held over on a month-to-month basis while a new agreement is finalized. The landing fee methodology in the expired Terminal A Use and Lease agreement, which is identical to that of the Terminal C Use and Lease Agreement (see below), is expected to remain the same in the new agreement.

**Intercontinental Terminal B Improvement Projects and Special Facilities Lease.** In connection with the redevelopment of Terminal B, the City and Continental (now United) entered into an Amended and Restated Special Facilities Lease with a term of thirty years, subject to certain early termination provisions and extension provisions on or about November 17, 2011. Pursuant to the Amended and Restated Special Facilities Lease, the City leases to United all of Terminal B, as well as certain special facilities located in Terminal C that were financed with proceeds of previously issued special facilities bonds. United may elect to proceed with future phases of the Terminal B project and finance and construct future facilities with additional special facilities bonds under the terms set forth in such lease.

The Terminal B Improvement Projects are expected to be accomplished in phases. It calls for United to build a new Terminal B South Concourse for regional jet aircraft and a new international-capable Terminal B North Concourse for both mainline and regional jet aircraft, add a Terminal B Federal Inspections Services (FIS) facility and rebuild the Terminal B central lobby and baggage claim areas. The first phase will replace Terminal B's two existing south circular flight stations used by United with a new South Concourse building at Terminal B for United's regional jet operations at Intercontinental. Total capital costs of the entire Terminal B Improvement Projects to United are expected to equal

approximately \$675 million and are expected to be financed in part with special facilities revenue bonds issued by the City on behalf of the airline.

To support the Terminal B Improvement Projects, the Houston Airport System has agreed to undertake certain capital projects to be completed concurrently with United's capital projects at Terminal B. The Houston Airport System's capital projects include ramp and apron replacement and roadway, signage, inter-terminal train, utility, environmental and fuel system relocation or improvements. The first phase of the City's capital program is expected to cost approximately \$53 million. The total cost to the City of the Terminal B Improvement Projects is estimated to equal \$265.1 million. It is anticipated that the City's capital program will be financed largely with grants and PFCs and other revenue sources.

As security for the Airport System Special Facilities Revenue Bonds (Continental Airlines, Inc. Terminal B Project), Series 2011, the Amended and Restated Special Facilities Lease obligates United to pay rent, directly to the trustee, equal to the debt service on the special facility bonds. In addition, following substantial completion of each phase or segment of the Terminal B Improvement Projects, United will pay the City a Terminal B Rental Rate that is comprised of the following: (1) certain allocated operation and maintenance expenses; (2) an allocation of certain costs relating to amortization of capital project improvements; (3) interest on the cost of land; (4) replenishment of the renewal and replacement fund; and (5) certain costs relating to administrative space, the automated people mover system, Terminal B apron charges and ground lease rentals.

***Intercontinental Terminal C Use and Lease Agreements.*** United's Airport Use and Lease Agreement, as it relates to Terminal C, expires on December 31, 2027, as does the term of the Terminal C Special Facilities Lease Agreement. The Terminal C Use and Lease Agreement gives United the preferential right to use all of the apron area and exclusive right to use of all of the holdrooms and other airline space in Terminal C for the duration of the lease term. The Amended and Restated Special Facilities Lease also covers certain improvements made by United in Terminal B, Terminal C and Terminal D at Intercontinental. These improvements were financed by the Airport System Special Facility Revenue Bonds, Series 1997B and Series 1998B, originally issued in the principal amounts of \$71,200,000 and \$20,630,000, respectively. United continues to have an obligation to pay debt service, if any, which becomes due and payable after expiration of the Lease.

The Airport Use and Lease Agreement provides for Terminal C building rental rates to be calculated according to a "compensatory" rate-making methodology that has been in effect since Intercontinental opened in 1969 and which includes: (1) the City treating each terminal or major capital component at Intercontinental (Terminals A, B, C, D, E, the Central FIS Facility and the APM) as a separate cost center for rates and charges purposes and (2) computing capital costs in the airline rate base (terminals and airfield) to reflect level annual amortization of investments. Costs associated with public and concession areas of the terminals are the responsibility of the City and are recovered through concession revenues (including parking, rental car and ground transportation revenues) and other eligible non-airline revenues.

In calculating airline fees, rentals and any other charges at Intercontinental, the total costs of all support facilities such as the inter-terminal train system and the chilled and hot water plant are allocated among the various areas that benefit from such facilities, including airline areas of the terminal buildings. In addition, the City charges apron fees that are calculated to recover costs allocable to the aprons. Finally, landing fees are calculated according to a formula through which the airlines are required to pay their pro-rata share of all costs allocable to the airfield cost center after first deducting airfield revenues derived from general aviation (principally fuel flowage fees, if any).

***Intercontinental Terminal D International Facilities Agreement.*** United and carriers providing international service at Terminal D, which utilizes the Central FIS Facility, operate under the terms of the International Facilities Agreement on a month-to-month basis, which does not extend beyond June 30, 2015. The agreement sets forth the methodology for calculating rates and charges for the use of the facility. The methodology is generally based on the compensatory rate-making concepts in effect in the other leases and agreements, but charges are separately calculated for services relating to arrival, departure, ticketing, Central FIS Facility, APM and club activity, among others.

***Intercontinental Terminal E Lease and Special Facilities Lease Agreement.*** The term of the Terminal E Lease and Special Facilities Lease Agreement relating to the central ticketing facility, Terminal E baggage system improvements, Terminal C-East garage, ATO facility, Terminal E apron area and fuel systems and ancillary facilities, commenced August 29, 2001 and is scheduled to terminate on January 25, 2030. United has the option to extend the term for an additional 5-

year period, subject to certain conditions. United net leased the facilities on an exclusive basis, with the exception of the Terminal E Apron area and fuel systems, which are leased on a preferential basis.

As security for the Airport System Special Facilities Revenues Bonds (Continental Airlines, Inc. Terminal E Project), Series 2001, the Terminal E Special Facilities Lease obligates United to pay rent, directly to the trustee, equal to debt service on the bonds. In addition, United is obligated to pay the City ground rentals for the special facility areas and “city charges” for the portions of the facilities financed by the City as well as certain allocated costs relating to capital project amortization, maintenance, and operations costs, replenishment of the renewal and extension fund for systems costs, and airport and departmental administrative costs. In consideration of United’s net leasing of the entire Terminal E and central ticketing facility (including the public areas), United is entitled to the revenues from all “inside concessions” at Terminal E, such as revenues from concession agreements for food and beverage, gift/news, telephone and advertising.

#### ***Other United Lease Agreements at Intercontinental***

Continental (now United) entered into a Special Facilities Lease Agreement in March 1997 with respect to the automated people mover (APM) project connecting Terminals B and C at Intercontinental. The project was financed with the City’s Special Facilities Revenue Bonds, Series 1997A, issued in the principal amount of \$74,200,000. The Special Facilities Lease Agreement (Automated People Mover) obligates United to pay rent to the City equal to debt service on the bonds. The City subleased the link between Terminals B and C from United effective January 25, 2005, when the link between Terminals C and D was placed into service and assumed the debt obligations.

United also operates two hangars, a mail sort facility, a cargo facility, a pilot simulator training center and other similar capital items at Intercontinental under a special facilities lease. The term of the lease expires in 2027.

The construction and improvement of the United facilities (such as a hangar at Intercontinental, a mail sort facility and simulator building) were partially financed by the Airport System Special Facilities Revenue Bonds, Series 1997C and Series 1998C, which were originally issued in the amount of \$44,600,00 and \$25,675,000, respectively. These Special Facilities Revenue Bonds are not obligations of the Houston Airport System. United has a continuing obligation to pay debt service, if any, which may become due and payable after expiration of the special facilities lease.

United leases approximately 4,400 parking spaces principally near economy parking at Intercontinental. The spaces are primarily for employee use. This lease agreement is scheduled to expire on May 13, 2013.

***Hobby Use and Lease Agreements.*** The airport use and lease agreement for the airlines operating at Hobby are similar in form and substance to the agreements at Intercontinental, but with certain differences in rate-making methodology that resulted in the division of Hobby into two sub-cost centers: the Terminal Building and the Central Concourse. The City does not expect there to be any further division of cost centers into “airline” and “public/concession space” as is the practice at Intercontinental. Under the Hobby use and lease agreements, landing fees are calculated using the same formula as is used at Intercontinental.

In September 2008, the City entered into new agreements with Southwest, Delta, and American Eagle that will expire on June 30, 2015. The City is finalizing agreements with JetBlue and Frontier to become signatories to the same use and lease agreement. Southwest has asked the Houston Airport System to evaluate the feasibility of flying internationally out of Hobby. As a result of those discussions the Houston Airport System has discussed the possibility of changing its rate-making methodology or changing the terms of its PFC collections at Hobby.

#### **Other Significant Airport Agreements**

##### ***Rental Car Facilities***

The consolidated rental car facility was financed in March 2001 with proceeds of the Airport System Special Facilities Taxable Revenue Bonds Series 2001 (Consolidated Rental Car Facility Project) issued in the principal amount of \$130,250,000. These special facility bonds are secured by and payable from a separate customer facility charge (“CFC”) assessed on rental car customers at Intercontinental. Under the terms of the Master Special Facilities Lease, the rental car

companies are responsible for all operation and maintenance costs associated with the facility and the associated busing operation. The lease is scheduled to expire on December 31, 2027.

The City has rental car agreements with nine rental car operators at Hobby. The agreements are scheduled to expire on May 31, 2012.

***Concessions, Cargo and Service Agreements***

Shown below is a summary of other significant non-airline agreements for the Houston Airport System.

**Houston Airport System  
Significant Non-Airline Agreements**

<u>Vendor</u>	<u>Expiration Date</u>	<u>Extension or Termination Options</u>	<u>Service Provided</u>	<u>Airport</u>
JC Decaux	December 29, 2012	N/A	Advertising	Intercontinental; Hobby
The Nuance Group	October 18, 2014	N/A	Duty Free	Intercontinental
Hudson News Company	May 22, 2015	N/A	News	Hobby
Concessions of Houston (DNC)	June 30, 2015	N/A	Food	Intercontinental
HMS Host	June 30, 2015	N/A	News, gift and specialty	Intercontinental
The Paradies Shops	June 30, 2015	N/A	News, gift and specialty	Intercontinental
JDDA SSP	December 31, 2016	N/A	Food	Intercontinental
Host of Houston Ltd.	October 30, 2019	N/A	Marriott	Intercontinental
4 Families of Houston	May 22, 2020	N/A	Food	Hobby
Federal Express	July 31, 2012	N/A	Freight, Mail	Intercontinental
UPS	December 31, 2022	2 ten-year optional extensions	Freight, Mail	Intercontinental
Aero Houston Central	December 31, 2024	N/A	Central Cargo	Intercontinental
Aero Houston East, L.L.C.	February 25, 2040	Option to terminate after 30 years	East Cargo	Intercontinental
Aero Houston East II, L.P.	February 28, 2043	Option to terminate after 30 years	East Cargo	Intercontinental
Trammel Crow Company IAH International Air Cargo II, L.P	August 31, 2049	Option to terminate after 30 years	Perishables Cargo	Intercontinental
Industrial Properties Corp.	February 28, 2043	Option to terminate after 30 years	East Cargo, Warehouse	Intercontinental
New South Parking –Texas	January 28, 2015	2 one-year optional extensions	Parking management	Intercontinental; Hobby
Bombardier Transportation (Holdings) USA Inc.	January 24, 2016	Maximum of 5-year optional extension	APM operation and maintenance	Intercontinental

Source: Houston Airport System

## THE AIRLINE INDUSTRY FINANCIAL INFORMATION

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

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

## INVESTMENT CONSIDERATIONS

### **Airline Concentration; Effect of Airline Industry Consolidation**

On October 1, 2010, Continental became a wholly-owned subsidiary of United Continental Holdings, Inc. ("UCH") as a result of the merger of a subsidiary of UCH with and into Continental. (United is also a wholly-owned subsidiary of UCH.) UCH has assumed all of Continental's obligations. The combined airline received a single operating certificate from the FAA on November 30, 2011. In early March 2012, the two airlines achieved full integration and began operating under the name "United Airlines."

In addition, Southwest announced on May 2, 2011, that it had closed its purchase of all of the outstanding common stock of AirTran Holdings, Inc., the former parent company of AirTran Airways (AirTran). Southwest and AirTran received approval for a single operating certificate from the FAA on March 1, 2012. Southwest will work toward full integration of AirTran. Southwest is the largest passenger airline at Hobby over the next several years.

Further airline consolidation remains possible. While the Houston Airport System believes that recent merger activity has had little impact on the respective combined airlines' market shares at Hobby or Intercontinental, future mergers or alliances among airlines operating at the Houston Airport System's facilities may result in fewer flights or decreases in gate utilization. Such decreases could result in reduced Net Revenues, reduced PFC collections and increased costs for the other airlines using the Houston Airport System.

Historically, when airlines have reduced or ceased operations at the Houston Airport System, other airlines have absorbed the traffic with no significant adverse impact on the Houston Airport System revenues. However, it is possible that if UCH ceased or significantly reduced operations at Intercontinental, revenues, PFC collections and costs for other airlines using the Houston Airport System could be adversely affected.

United and Southwest/AirTrans account for a significant portion of the Houston Airport System's operating revenues. For more information, see Note 10 of the Notes to the Financial Statements as set forth in APPENDIX A. If either airline were to significantly reduce service it may have a material impact on revenues, including concession revenues and PFC collections, and on the resulting cost per enplanement charged at each airport.

### **FAA Reauthorization**

Congressional authorization for the FAA's operating authority, including various aviation programs and excise taxes, expired in 2007 and has been subsequently extended by Congress for only short time periods. On February 14, 2012, the President signed into law the FAA Modernization and Reform Act of 2012, which establishes Federal funding for the FAA for fiscal years 2012-2015. Failure of Congress to reauthorize the FAA's operating authority beyond that period, or adverse changes in the conditions placed on such authority, may have an adverse impact on Houston Airport System operations over the long-run because grants awarded under the FAA's Airport Improvement Program have been a significant source of financing for the Houston Airport System.

### **Availability of PFCs**

The Houston Airport System currently uses PFC collections to pay a portion of its debt service and to fund certain pay-as-you-go projects. For its fiscal year 2012 budget, the Houston Airport System has committed \$32.2 million of PFCs to pay senior lien and subordinate lien debt service. The collection of PFCs is subject to several risks. First, the amount of PFCs received by the Houston Airport System depends on the actual number of PFC-eligible passenger enplanements at Intercontinental and Hobby. If enplanements decline, PFC collections will also decline. Further, the PFC authorizations for Intercontinental and Hobby expire in November 2027 and November 2017, respectively, and may not be extended beyond these dates by the FAA. Finally, the Houston Airport System's authority to impose PFCs could be terminated if it violates Department of Transportation regulations regarding their use. A shortfall in PFC collections would require the Houston Airport System to pay these debt service costs from existing cash balances or from net revenues unless it successfully increases the rate at which PFCs are collected. The PFC rate is currently \$3.00 per enplaned passenger at each of Intercontinental and Hobby, although the maximum authorized rate is currently \$4.50 per enplanement.

### **Airport Security**

The terrorist attacks on September 11, 2001 led to increased safety and security measures at Intercontinental and Hobby as mandated by the FAA and the Aviation and Transportation Security Act passed by Congress in November 2001. At that time, the Transportation Security Administration assumed certain safety and security procedures and operations from the Houston Airport System. Despite these new safety measures, additional acts of terrorism, which could reduce passenger traffic or airport revenues, are possible. The Houston Airport System maintains property insurance to cover terrorism jointly and severally with the City and the City's other enterprise departments. However, this policy covers only part of the total property value of the Houston Airport System. Deductibles or any costs in excess of insured amounts would be borne by the City or airlines.

### **Hurricane Activity**

The southernmost portion of the City is located approximately 50 miles north of the Gulf of Mexico. The Gulf region is prone to seasonal hurricane activity; major hurricanes or related storms may develop. A hurricane of great severity, as measured categorically by the Saffir-Simpson index, could significantly damage Houston Airport System properties. The Houston Airport System maintains hurricane insurance jointly and severally with the City and its other enterprise departments, but the policy covers only part of the total property value of the Houston Airport System. Deductibles or any costs in excess of insured amounts would be borne by the City or the airlines.

### **Changes in Federal Legislation Relating to the Wright Amendment**

In February 1980, Congress passed what is commonly referred to as the "Wright Amendment" as a part of the International Air Transportation Competition Act of 1979. The Wright Amendment limited interstate commercial airline passenger services out of Love Field in the City of Dallas, Texas, a hub for Southwest Airlines, (i) to any interstate destinations in aircraft having a passenger capacity of 56 seats or less (the "Commuter Aircraft Exception"), or on charter

flights not exceeding 10 per month, and (ii) to the four states adjacent to Texas in aircraft of any size, subject to certain restrictions on through-service or ticketing, and operational restrictions on the flight or aircraft serving any point outside such adjacent states. In 1997, Congress passed the so-called “Shelby Amendment.” That legislation (i) expanded the adjacent-state rule of the Wright Amendment to add three states to the four states adjacent to Texas and (ii) provided that an aircraft weighing not more than 300,000 pounds that is reconfigured to accommodate 56 or fewer passengers would be in compliance with the Commuter Aircraft Exception of the Wright Amendment, regardless of its destination. In 2005, Congress expanded the adjacent-state rule to include Missouri thus allowing non-stop flights from Love Field to a total of eight states. On October 13, 2006, President Bush signed into law legislation that (i) allows one-stop and through-service ticketing outside of the Wright Amendment’s former restrictions, (ii) reduces Love Field’s maximum gate capacity from 32 to 20 gates and (iii) completely repeals the Wright Amendment in 2014. The impact on the Houston Airport System of the repeal of the Wright Amendment in 2014 cannot be predicted at this time.

### **General Factors Affecting Air Traffic at the Houston Airport System**

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

### **Financial Condition of the Airlines**

The ability of the Houston Airport System to generate revenues depends, in part, upon the financial health of the aviation industry in general. The economic condition of the aviation industry is volatile, and the industry has undergone significant changes, including mergers, acquisitions, bankruptcies and closures in recent years. Further, the aviation industry is sensitive to a variety of factors, including (i) the cost and availability of financing, labor, fuel, aircraft and insurance, (ii) national and international economic conditions, (iii) international trade, (iv) currency values, (v) competitive considerations, including the effects of airline ticket pricing, (vi) traffic and airport capacity constraints of the Houston Airport System and competing airports, (vii) governmental regulation, including security regulations and taxes imposed on airlines and passengers, and maintenance and environmental requirements, (viii) passenger demand for air travel and (ix) disruption caused by airline accidents, criminal incidents and acts of war or terrorism, such as the events of September 11, 2001. The aviation industry is also vulnerable to strikes and other union activities.

The revenues of the airlines using the Houston Airport System and, as a consequence, the Houston Airport System may be materially affected by many factors including, without limitation, the following:

**Cost of Fuel.** Airline earnings are significantly affected by the price of aviation fuel. According to the Air Transport Association (the “ATA”), fuel is the largest cost component of airline operations and, therefore, an important and uncertain determinant of an air carrier’s operating economics. There has been no shortage of aviation fuel since the “fuel crisis” of 1974, but there have been significant price increases for fuel.

Any unhedged increase in fuel prices causes an increase in airline operating costs. According to the ATA, a one-dollar per barrel increase in the price of crude oil equates to approximately \$415 million in annual additional expense for U.S. airlines. Fuel prices continue to be susceptible to, among other factors, political unrest, Organization of Petroleum Exporting Countries policy, increased demand for fuel caused by rapid growth of economies such as China and India, fuel inventory maintained by certain industries, reserves maintained by governments, currency fluctuations, disruptions to production and refining facilities and weather. In recent years, the cost of aviation fuel has risen sharply in response both to political instability abroad as well as increased demand for petroleum products around the world. Oil prices have become volatile in recent years: they reached an all-time high of \$145.18 per barrel in July 2008, declined to an average of \$61.95 per barrel in 2009, rebounded to \$79.48 per barrel in 2010, jumped to \$94.88 per barrel in 2011 and have averaged \$99.71 per barrel through February 14, 2012. Significant fluctuations and prolonged increases in the cost of aviation fuel have adversely affected air transportation industry profitability, causing airlines to reduce capacity, fleet and personnel and to

increase airfares and institute fuel, checked baggage and other extra surcharges, all of which may decrease demand for air travel.

***National Economic Conditions.*** Historically, the financial performance of the air transportation industry has correlated with the state of the national economy. Future increases in passenger traffic will depend largely on the ability of the United States to sustain growth in economic output and income. On August 5, 2011 the rating agency Standard and Poor's downgraded the credit of the United States to AA+ from AAA. The short term and long term financial implications of the downgrade are unclear. However, a continued lack of sustainable economic growth combined with high federal and state and local deficits could pressure the nation's financial markets, manufacturing activity and customer spending. There can be no assurances that such developments will not adversely affect the air transportation industry.

***Global Economic and Political Conditions.*** Worldwide economic and political conditions have become more volatile and unpredictable. In the Middle East several governments including those in Libya and in Egypt have been overthrown. In Europe, the countries of Greece, Spain, Ireland Portugal and Italy have all experienced significant reductions in economic activities. Greece has rescheduled debt payments. Several countries including France, Italy, Spain and Greece have had their sovereign credit ratings decreased. The short term and long term implications of all these conditions are unclear. However, these developments could adversely impact the air transportation industry.

***Structural Changes in the Travel Market.*** Many factors have combined to alter consumer travel patterns. The threat of terrorism against the United States remains high. As a result, the federal government has mandated various security measures that have resulted in new security taxes and fees and longer passenger processing and wait times at airports. Both add to the costs of air travel and make air travel less attractive to consumers relative to ground transportation, especially to short-haul destinations. Additionally, consumers have become more price-sensitive. Efforts of airlines to stimulate traffic by heavily discounting fares have changed consumer expectations regarding airfares. In addition, the availability of fully transparent price information on the Internet now allows quick and easy comparison shopping, which has changed consumer purchasing habits. Consumers have shifted from purchasing paper tickets from travel agencies or airline ticketing offices to purchasing electronic tickets over the Internet. This has made pricing and marketing even more competitive in the U.S. airline industry. Finally, smaller corporate travel budgets, combined with the higher time costs of travel, have made business customers more amenable to communications substitutes such as tele- and video-conferencing.

***Threat of Terrorism.*** The 2001 terrorist attacks against the United States and similar attacks in other parts of the world, the conflicts in Iraq and Afghanistan and the increased threat of further terrorist attacks decreased passenger traffic levels at the Houston Airport System and nationwide. Should new attacks occur against the air transportation industry, the travel industry, cities, utilities, infrastructure, office buildings or manufacturing plants, there could be a materially adverse effect on travel demand.

***Capacity of National Air Traffic Control and Airport Systems.*** Demands on the national air traffic control system continue to cause aircraft delays and restrictions, both on the number of aircraft movements in certain air traffic routes and on the number of landings and takeoffs at certain airports. These restrictions affect airline schedules and passenger traffic nationwide. The Federal Aviation Administration is gradually automating and enhancing the computer, radar, and communications equipment of the air traffic control system and assisting in the development of additional airfield capacity through the construction of new runways and the more effective use of existing runways. However, increasing demands on the national air traffic control and airport systems could cause increased delays and restrictions in the future.

***Airline Capital Markets Access.*** Historically, airlines have required access to third-party capital to finance significant portions of their aircraft and non-aircraft capital needs. If the capital markets were to become inaccessible by either U.S. airlines or international airlines, it could significantly impact their ability to provide scheduled service to and from the Houston Airport System's airports or undertake contractual capital commitments.

## **Cost and Completion Schedule of Houston Airport System Capital Improvement Program**

The costs and completion timeframe of capital projects included in the Houston Airport System's CIP are subject to a number of uncertainties. The ability of the Houston Airport System to complete the Fiscal Year 2012-2016 CIP may be adversely affected by various factors including: (i) estimating errors, (ii) design and engineering errors, (iii) changes to the scope of the projects, (iv) delays in contract awards, (v) material, and/or labor shortages, (vi) unforeseen site conditions,



(vii) adverse weather conditions, (viii) contractor defaults, (ix) labor disputes, (x) unanticipated levels of inflation, (xi) environmental issues, including environmental approvals that the Houston Airport System has not obtained at this time, (xii) additional security improvements and associated costs mandated by the federal government, and (xiii) lack of adequate funding, including inability to access the capital markets or loss of grants or PFCs.

A delay in the completion of certain projects under the Fiscal Year 2012-2016 CIP could delay the collection of revenues for such projects, increase project costs, or cause the rescheduling of other projects. There can be no assurance that the cost of construction of the 2012-2016 CIP projects will not exceed the currently estimated dollar amount or that the completion of the projects will not be delayed beyond the currently projected completion dates. Any schedule delays or cost increases could result in the need to issue additional Houston Airport System Bonds and may result in increased costs per enplaned passenger to the airlines, which could place the Houston Airport System at a competitive disadvantage with other airports. Further, changes in the mix of the projects which comprise the Houston Airport System's CIP could negatively impact the long-term revenue base of the Houston Airport System. This could occur if there were a substantial shift to the capital projects that the Houston Airport System is required to fund out of non-airline revenues versus those that become part of the airline rate base and for which the Houston Airport System receives airline revenues through landing fees and terminal rentals. In such case, the Houston Airport System would seek to alter its rate-making methodology or find additional revenue sources. See "THE HOUSTON AIRPORT SYSTEM – Houston Airport System Capital Improvement Program."

#### **Airport Capital Markets Access.**

Airports have also historically required access to third-party capital to finance significant portions of their capital needs and to effectively manage their cost per enplanement or debt coverage ratios. If the capital markets were to become inaccessible by the Houston Airport System, it could significantly impact the Houston Airport System's ability to meet its prospective coverage ratios or to meet its future spending needs or to achieve a competitive cost per enplanement.

#### **Parking and Concession Revenues**

City-owned parking facilities are the largest single source of non-airline revenues. City's parking facilities compete with several off-site private parking operators that provide free shuttle service to the airport to their customers at both Intercontinental and Hobby. Accordingly, competitive supply and demand constraints have affected the City's ability to significantly increase parking revenues, and may continue to effect revenues, at its on-site economy parking facilities. Additionally, the range of approved parking rates must be established by City Council, which may limit the Houston Airport System's ability to increase rates for either its structured parking or economy parking facilities.

Concessions are the second largest source of non-airline revenues for the Houston Airport System. Under the Amended and Restated Special Facilities Lease executed in connection with the Terminal B redevelopment, concession revenues earned from operations in the new Terminal B facility will accrue largely for the benefit of United. In the past, the City earned a percentage of revenues from the concession operators in Terminal B. While the Houston Airport System expects to reduce operations and maintenance costs to fully offset the loss of these concession revenues there can be no assurance that it will be able to do so.

#### **Effect of Airline Bankruptcies**

Prior bankruptcies by airlines using the Houston Airport System have resulted in reductions of service levels by particular airlines, even in cases where such airlines continued to operate in bankruptcy. Additional bankruptcies, liquidations or major restructurings of other airlines could occur. The bankruptcy of an airline with significant operations at the Houston Airport System, such as United or Southwest, could have a material adverse effect on operations at the Houston Airport System, revenues, and the cost to the other airlines operating at the Houston Airport System. It is uncertain how airline bankruptcies, liquidations or restructurings would affect the Houston Airport System.

***Airline Lease Agreements.*** In the event of bankruptcy proceedings involving one or more of the airlines operating at the Houston Airport System, the debtor or its bankruptcy trustee must determine within a time period determined by the court whether to assume or reject the applicable airline's use and lease agreement or other lease agreements. If assumed, the debtor would be required to cure any prior defaults and to provide adequate assurance of

future performance under the relevant agreements. Rejection of a lease or executory contract by an airline would give the City an unsecured claim for damages, the amount of which in the case of a lease is limited by the Bankruptcy Code.

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

The PFC Act provides that PFCs collected by the airlines constitute a trust fund held for the beneficial interest of the eligible agency (i.e., the City) imposing the PFCs, except for any handling fee or retention of interest collected on unremitted proceeds. In addition, federal regulations require airlines to account for PFC collections separately and to disclose the existence and amount of funds regarded as trust funds for financial statements. However, the airlines are permitted to commingle PFC collections with other revenues and are also entitled to retain interest earned on PFC collections until such PFC collections are remitted. In the event of a bankruptcy, the PFC Act, as amended in December 2003, provides that (1) PFCs are and remain trust funds, (2) the airline in bankruptcy may not grant to any third party any security or other interest in PFC Revenues, and (3) the airline in bankruptcy must segregate in a separate account PFC Revenues equal to its average monthly PFC liability as well as postpetition actual PFCs. Despite these enhanced statutory protections, it is unclear whether the City would be able to recover the full amount of PFC trust funds collected or accrued by an airline in the event of a liquidation or cessation of business. The City also cannot predict whether an airline operating at Hobby or Intercontinental that files for bankruptcy would have properly accounted for PFCs owed to the City or whether the bankruptcy estate would have sufficient moneys to pay the City in full for PFCs owed by such airline. The PFCs are not pledged to the payment of the Series 2012 Bonds. For a discussion of the treatment of PFC Revenues under the Ordinance, see APPENDIX B-1.

There may be other possible effects of a bankruptcy of an airline that could result in delays or reductions in revenues received by the Houston Airport System and potentially in delays or reductions in payments on the Series 2012 Bonds. Regardless of any specific adverse determinations in an airline bankruptcy proceeding, the fact of an airline bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2012 Bonds.

#### ***Recent Bankruptcies and Non-Judicial Restructurings***

On November 29, 2011, AMR and certain of its subsidiaries (including American Airlines and American Eagle) filed voluntary petitions for Chapter 11 reorganization in the U.S. Bankruptcy Court for the Southern District of New York. The company stated that the bankruptcy filing was undertaken to achieve a cost and capital structure that is industry competitive. American Airlines and American Eagle fly out of Intercontinental and Hobby, respectively. The Houston Airport System acts as a spoke and not a hub city for American and American Eagle’s scheduled passenger service. As a result, the Houston Airport System does not have significant pre-petition financial exposure due to the filing, and the Houston Airport System does not expect that the carriers will significantly change their scheduled service out of the Houston Airport System due to their reorganization. The Houston Airport System has been collecting PFCs from American and American Eagle as provided under the PFC Act.

Pinnacle Airlines and Colgan Air serve the Houston Airport System as regional partners for Delta Airlines and United Airlines, respectively. Pinnacle provides scheduled CRJ-900 regional jet service for Delta out of Hobby, and Colgan provides Q400 turbo-prop service for United out of Intercontinental. On January 20, 2012 the company publicly warned of a possible Chapter 11 filing citing uncompetitive labor costs. While it is impossible to ascertain the exact impact of a Chapter 11 filing, if any, the Houston Airport System does not believe that the financial exposure is material.

## **THE CITY AND CITY FINANCIAL INFORMATION**

### **Governmental Structure**

The City has a mayor-council form of government in which the Mayor and the 16-member City Council serve as the legislative body. Eleven council members are elected by district and five council members are elected at-large. The Mayor, all members of the City Council and the City Controller are elected for two-year terms. The present term of office

for all elected officials expires in January 2014. The City Charter limits the terms of office for all elected City officials to three two-year terms.

The Mayor is the City's chief executive officer. The Mayor exercises administrative control over the City's government; presides over City Council meetings; establishes the City Council agenda; and appoints the heads of the various departments of the City, subject to confirmation by the City Council. The Mayor also is responsible for preparing and submitting the City's annual budget proposals to the City Council for adoption.

The City Controller is the City's chief financial officer. The Office of the City Controller superintends, supervises, manages and conducts the fiscal affairs of the City; maintains the books of accounts; prepares financial statements; conducts the sales of City obligations; certifies the availability of funds before the City incurs any financial obligation; and, along with the Mayor, countersigns all warrants, contracts or orders for payment of any money by the City.

### **Home-Rule Charter**

Although the City is a home-rule city under the Texas Constitution, it may not adopt ordinances or charter provisions inconsistent with Texas law. Under the Texas Constitution, the City Charter may be amended not more than once every two years at an election held for that purpose, which may be called by the City Council or upon petition of 20,000 of the City's registered voters. The last City Charter amendments were adopted on November 2, 2010. See "– City Charter Tax and Revenue Limitations." In addition, the City Charter allows the City's voters to exercise the powers of initiative and referendum. To enact an initiative ordinance, a petition signed by voters equal in number to at least 15% of the greater total vote cast for Mayor in any general election in the preceding three years must be submitted to the City. Thereafter, the City Council may enact the ordinance or call an election on the question of its adoption. In order to exercise the referendum power, a petition signed by voters equal in number to at least 10% of the greater total vote cast for Mayor in any general election in the preceding three years must be submitted to the City. City Council may repeal the ordinance that is the subject of the referendum petition or submit the issue to the electorate. See "– City Charter Tax and Revenue Limitations."

### **City Interest Rate Swap Policy**

To date, the City has not entered into any Qualified Hedge Agreements (i.e., swaps) in connection with any Houston Airport System Bonds.

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

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

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

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

### **Investment of Moneys**

The City maintains an investment strategy that emphasizes, in order of priority, safety, liquidity and return on investment, as embodied in its investment policy (the "Policy"). The City does not invest in inverse floaters, or interest-only or principal-only mortgage-backed securities. The Policy provides, among other things, that (1) the Investment Manager (as defined in the Policy) shall submit quarterly investment reports to City Council and (2) the Policy shall be reviewed annually by City Council. For a further discussion of the Houston Airport System Fund investments as of June 30, 2011, see Note 1.E.1 and Note 3.B of the Notes to the Financial Statements as set forth in APPENDIX A. On December 14, 2011, the City Council amended the Investment Policy to incorporate amendments to the Public Funds Investment Act (PFIA).

Fitch Ratings has assigned a "AAA" credit quality rating to the City's General Investment Portfolio. The ratings reflect the view of Fitch Ratings, from whom an explanation of the significance of such ratings may be obtained.

The Ordinance provides that all interest and income derived from the deposit and investment of amounts held in all Funds will be transferred or credited monthly to the Revenue Fund and shall constitute Gross Revenues of the Houston Airport System (unless specifically excluded from the definition of Gross Revenues), except as follows: (1) all interest and income derived from deposits and investments credited to the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund and the Operation and Maintenance Reserve Fund will remain in such funds to the extent necessary to accumulate the Reserve Fund Requirements or other required balance therein; and (2) all interest and income derived from deposits and investments held in any construction fund, including amounts held therein as capitalized interest, created by any ordinance authorizing the issuance of Houston Airport System Bonds will remain in such construction fund for disposition in the manner provided in the applicable ordinance. Notwithstanding anything to the contrary contained in the Ordinance, any interest and income derived from deposits and investments of any amounts credited to any fund or account may be paid to the federal government if in the opinion of nationally recognized bond counsel such payment is required in order to prevent interest on any Houston Airport System Bonds from being includable within the gross income of the owners thereof for federal income tax purposes.

### **Health Care Benefits for Retired Employees**

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

The City's most recent actuarial study indicates that as of July 1, 2010, (i) the City's actuarial accrued liability ("AAL") for the portion of the total liability for projected benefits expected to be paid to the City's municipal employees and classified police officers and firefighters not funded by normal cost payments was approximately \$2.0 billion and (ii) the annually required contribution that would be required to pay the normal costs of the benefits and to effect a level amortization of the AAL over a 30-year period would have been approximately \$237.5 million. The AAL measured as of June 30, 2009, was approximately \$3.1 billion. The reduction in AAL from \$3.1 billion to \$2.0 billion results from changes in treatment of those eligible for Medicare, certain actuarial gain, assumption changes and the impact of certain plan changes made as of May 1, 2011.

Similar to many issuers, the City's current practice has been to fund the cost of OPEB on an annual pay-as-you-go basis and to account for OPEB costs as a current operating expense in the Fiscal Year in which the OPEB cost is paid. In Fiscal Year 2009 the Houston Airport System switched to an accrual basis to record these liabilities, in accordance with Generally Accepted Accounting Principles. As a result, the Fund's expense increased starting in Fiscal Year 2009. The total expense recognized for Fiscal Year 2009, Fiscal Year 2010, and Fiscal Year 2011 was \$11.1 million, \$11.2 million and \$9.8 million, respectively. The Houston Airport System Fund's budget for Fiscal Year 2012 is \$1.3 million. To date, the City has not accumulated assets to offset future benefit costs.

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

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

See also APPENDIX A, particularly Note 8 of the Houston Airport System Fund's audited financial statements for Fiscal Year 2011, which includes information relating to retiree health care premiums paid by the City in Fiscal Year 2008, as well as information relating to health and long-term disability benefits.

***Bargaining with Other Municipal Employees.*** The Texas Legislature recently enacted Chapter 146 of the Local Government Code ("Chapter 146"), which extended to municipal employees of the City, other than department heads, firefighters and police officers, the right to appoint bargaining agents to "meet and confer" with representatives of the City or any agency, board, commission or political subdivision that is required to establish wages, salaries, rates of pay, hours, working conditions or other terms and conditions of employment regarding such issues. Chapter 146 prohibits municipal employees from engaging in strikes and specifically prohibits the bargaining agent and the City from entering into agreements regarding pension-related matters governed by Article 6243g, Vernon's Texas Civil Statutes, or a successor statute (now Article 6243h, Vernon's Texas Civil Statutes). See "- Employee Pension Funds." However, any agreement affecting the salaries of municipal employees will likely have an effect on the City's pension liabilities.

In order to invoke the provisions of Chapter 146, a majority of the municipal employees must submit a petition requesting the recognition of a particular employee association as the sole and exclusive bargaining agent for all covered employees before the City may begin negotiations with the employee association. After receiving such a petition, the City may (i) grant recognition of the association as requested in the petition and meet and confer under Chapter 146 without an election by the voters of the City, (ii) order an election to determine whether the City may meet and confer under Chapter 146 or (iii) order a certification election to determine whether the employee association represents a majority of the covered employees.

The City has recognized the Houston Organization of Public Employees ("HOPE") as the exclusive bargaining agent for all covered employees. The City and HOPE entered into a meet and confer agreement that expired on June 30, 2011. A new meet and confer agreement was ratified and approved by City Council and went into effect August 18, 2011. The agreement will expire June 30, 2015 and will provide for a pay increase of 2% in 2013 (with the potential for an additional 1% in 2013 conditioned upon the City's achievement of certain revenue benchmarks identified by the parties) and 3% in 2014. Following the expiration of such agreement, there no longer will be a contractual obligation for pay increases by the City. While pension benefits and contributions are not part of the meet and confer agreement, the increase in wages previously agreed to will affect the City's pension contributions. The City has recently reached an agreement with the Houston Municipal Employees Pension Board ("HMEPS") specifically related to pension benefits and contributions. Only a minority of Houston Airport System employees are covered by the union. See also the section captioned "- Employee Pension Funds" for a discussion of the "meet and confer" process for HMEPS.

## Employee Pension Funds

### *General Overview*

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

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

Virtually all of the Houston Airport System’s employees are members of the Municipal System, and the Houston Airport System is directly responsible only for the costs of funding the portion of the City’s Municipal System contributions associated with employees of the Houston Airport System. See “– Houston Airport System’s Contributions to the Municipal System,” below. Due to the small number of classified police and firefighters employed by the Houston Airport System, the anticipated increases in City contributions to the Police System and Firefighter Fund in future fiscal years should not have a substantial financial impact on the Houston Airport System.

**Funding Status.** In 2001, benefit increases in the Municipal System were adopted by the Texas legislature that increased the future actuarially determined contributions and corresponding unfunded AAL (“UAAL”) components. See “Schedule 9: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability.” These benefit changes were supported jointly by the City and representatives of the Municipal System based on an actuarial cost analysis performed by the Municipal System’s actuary. The 2001 benefit changes, in combination with lower than expected investment performance, resulted in an actuarially determined City contribution rate of 52.9% of payroll and a UAAL of approximately \$1.8 billion as of July 1, 2003.

As a result of the increase in future actuarially determined contributions and their component UAALs, the City has taken a number of actions to improve the financial condition of the Municipal System. Pursuant to an election held on May 15, 2004, the voters authorized the City to opt-out of an amendment to the Texas Constitution that prohibits (unless the jurisdiction “opts out”) a reduction in or other impairment of the retirement or death benefits provided by the public retirement systems of political subdivisions that a member of such a system has “accrued.” In addition, the City and the Municipal System entered into a “meet and confer” agreement in 2004 (the “2004 HMEPS Agreement”). The 2004 HMEPS Agreement was considered by the City to be an intermediate step toward addressing the unexpected financial challenges arising from the 2001 benefit increases. To provide a more permanent, long term solution to those financial challenges, the City and the Municipal System subsequently entered into an amendment to the 2004 HMEPS Agreement (the “2007 HMEPS Agreement,” together with the 2004 HMEPS Agreement, the “HMEPS Agreements”) regarding benefit levels for current and future employees and employee and certain City contributions through Fiscal Year 2011. A further amendment was adopted in 2011 (the “2011 Agreement”), which established a long-term future contribution policy beginning in Fiscal Year 2012. See “– HMEPS Agreements” for a more complete description of the HMEPS Agreements.

As a result of the HMEPS Agreements, the actuarially determined contribution for the municipal system has been reduced to approximately 22.4% of payroll and the UAAL has been reduced to approximately \$1.36 billion as of July 1, 2010. See “Schedule 9: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability.”

The current City contribution for Fiscal Year 2012 is \$98.5 million, which is less than the actuarially determined amount; however, beginning with Fiscal Year 2013, the HMEPS agreement requires the future City contributions to be

equal to the actuarially determined amounts, provided that the year-over-year increase in City contribution cannot exceed 2% of payroll. As of the most recent July 1, 2010 actuarial valuation report, the City contribution is projected to be equal to the actuarially determined amount of 26% of payroll in Fiscal Year 2016.

**Schedule 9: Municipal System Pension Plan Assets, Liabilities and Unfunded Actuarial Accrued Liability**

	As of July 1 (in millions)				
	2006	2007	2008	2009	2010 <sup>(c)</sup>
Actuarial Accrued Liability	\$ 2,894	\$ 3,129	\$ 3,296	\$ 3,451	\$ 3,632
Actuarial Value of Plan Assets <sup>(a)</sup>	<u>(1,867)</u>	<u>(2,194)</u>	<u>(2,310)</u>	<u>(2,284)</u>	<u>(2,273)</u>
Unfunded Actuarial Accrued Liability	<u>\$ 1,027</u>	<u>\$ 935</u>	<u>\$ 986</u>	<u>\$ 1,167</u>	<u>\$ 1,359</u>
Funded Ratio <sup>(b)</sup>	65%	70%	70%	66%	63%

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

<sup>(b)</sup>Funded ratio means actuarial value of plan assets divided by accrued liability.

<sup>(c)</sup>Information is derived from HMEPS Actuarial Valuation dated July 1, 2010.

Source: Houston Airport System

***Houston Airport System’s Contributions to the Municipal System***

The City budgets for its contributions to the Municipal System by allocating the cost among its General Fund and various Enterprise Funds, like the Houston Airport System, based upon the percentage of total payroll paid by the funds. For Fiscal Year 2012, municipal employees of the Houston Airport System comprise approximately 11.8% of the total civilian workforce payroll of the City, and, accordingly, the Houston Airport System is responsible for approximately 11.8% (\$10 million) of the City’s \$98.5 million contribution to the Municipal System. The General Fund is responsible for approximately 46% (\$40 million) of the City’s contribution to the Municipal System, with the remainder being split by the City’s remaining Enterprise Funds. To the extent the share of budgeted payroll for municipal employees of the Houston Airport System changes in the future, the allocable percentage of the budgeted contributions by the Houston Airport System to the Municipal System will also change.

In addition to the cash contributions made by the City, the City has issued \$448 million in Pension Obligations for the benefit of HMEPS. Although these bonds are secured by a pledge of ad valorem tax revenues, the Houston Airport System is responsible for repaying its pro-rata share of debt service on \$2.0 million of pension obligation bonds issued by the City. This debt service payment is in addition to the Houston Airport System’s annual contribution to HMEPS based on the current payroll of active employees. The total cost to the Houston Airport System for its pension related payroll based contributions and debt service contributions was \$9.2 million for Fiscal Year 2009, \$9.6 million for Fiscal Year 2010, \$9.9 million for Fiscal Year 2011. The estimated contribution for Fiscal Year 2012 is \$11.8 million. In January 2009, the City refunded its \$300 million 2004 Collateralized Pension Note, including the Airport System’s portion. The City’s Fiscal Year 2012 contribution to the Municipal System will be \$98.5 million through “meet and confer” negotiations, which is approximately 21.9% of payroll.

***HMEPS Agreements***

The 2004 HMEPS Agreement was effective as of September 15, 2004, and will remain in effect until June 30, 2012. The 2004 HMEPS Agreement has three elements: (1) a funding commitment by the City for Fiscal Years 2005, 2006 and 2007, including a commitment to contribute cash, issue Pension Obligations, and contribute certain City assets; (2) a required increase in the employees’ contribution; and (3) benefit level reductions for employees hired prior to January 1, 2008. The 2007 HMEPS Agreement has three elements: (1) a funding commitment by the City for Fiscal Years 2008, 2009, 2010 and 2011; (2) a new noncontributory defined benefit plan with further reduced benefit levels for employees

hired after January 1, 2008; and (3) an agreement to reset the actuarial value of the Municipal System Assets to the market value of such assets as of July 1, 2006.

Under the terms of the 2007 HMEPS Agreement, the City made contributions to the Municipal System of \$75 million in Fiscal Year 2008, \$78.5 million in Fiscal Year 2009, \$83.5 million in Fiscal Year 2010 and \$88.5 million in Fiscal Year 2011.

Under the terms of the 2011 Agreement, the City will make a contribution of \$98.5 million in Fiscal Year 2012. Subsequent City contributions are expected to increase by 2% of payroll each year until Fiscal Year 2016 when the City will begin contributing the actuarially determined contribution amount of approximately 26% of payroll. The Houston Airport System will be responsible for approximately 12% of the City's scheduled contributions based upon the current percentage of the City's total municipal employee payroll paid by the Houston Airport System.

### **City Charter Tax and Revenue Limitations**

In 2004, voters approved two initiatives, Proposition 1 (2004) and Proposition 2 (2004) (both described below), proposing to reduce, cap or otherwise limit ad valorem tax revenues or other revenues of the City. A majority of the voters voted for both Proposition 1 (2004) and Proposition 2 (2004), but Proposition 1 (2004) received more favorable votes than Proposition 2 (2004). Because of language contained in Proposition 1 (2004) and the City Charter, the City has determined that Proposition 1 (2004) is effective and Proposition 2 (2004) is not. Notwithstanding, certain supporters of Proposition 2 (2004) filed a lawsuit in state district court seeking a declaratory judgment that Proposition 2 (2004) is valid and enforceable.

#### ***Description of the Propositions***

***Proposition 1 (2004).*** Proposition 1 limits increases in (i) the City's ad valorem tax revenues by requiring voter approval for increases in ad valorem taxes in future years above a limit equal to the lesser of the actual revenues in the preceding Fiscal Year, plus 4.5%, or a formula that is based upon the actual revenues received in Fiscal Year 2005 adjusted for the cumulative combined rates of inflation and the City's population growth; and (ii) water and sewer rates (i.e., the City's Combined Utility System) by limiting rate increases to the combined increases in the rates of inflation and population growth, excluding rate increases required by certain bond covenants and rates established by contract, unless approved by the voters.

***Proposition 2 (2004).*** Proposition 2 (2004) would limit increases in the City's "combined revenues," which would include revenues of the general fund, special revenue funds and enterprise funds, excluding only grant monies and revenues from other governmental entities. Proposition 2 (2004) would require 60% voter approval at a regular election to increase combined revenues over the combined revenues for the immediately preceding Fiscal Year, adjusted for the rates of change in the Consumer Price Index ("CPI") for the Houston area and the City's population. If the actual increase in the amounts of combined revenues for any given Fiscal Year is less than the allowable increase, then such reduced amount of combined revenues received by the City would be the baseline for the next Fiscal Year. If in any year the City's "combined revenues" exceed the amount allowed by Proposition 2 (2004), then the City would be required to deposit such excess in a taxpayer relief fund. If the balance in the taxpayer relief fund reaches \$10 million, such amount would be required to be refunded to taxpayers. Proposition 2 (2004) includes a provision that states that the City shall honor its covenants with bondholders such that shortfalls in debt coverage, among other covenants, shall be made up from reductions in other expenditures.

In response to these tax and revenue limitations, the City held an election on November 7, 2006 at which the voters approved Proposition G and Proposition H, which are currently effective. The City has incorporated Propositions G and H into its financial policies, and it anticipates collecting revenues and making expenditures for public safety purposes in compliance with Proposition H. The City Controller has verified that the current Fiscal Year 2012 Budget complies with Proposition 1 (2004). Based on the current status of the litigation described below, the City has determined that there is no legal requirement that it determine compliance with Proposition 2 (2004).

***Proposition G (2006).*** Proposition G amended the City Charter to exclude revenues of the City's enterprise systems (i.e., Combined Utility System, Houston Airport System and the Convention and Entertainment Facilities



Department) from the types of revenues limited under the City Charter. Voter approval of Proposition G removed the enterprise systems from the revenue limitations of Proposition 2 (2004), although the limitation on water and sewer rate increases included in Proposition 1 remains in effect.

***Status of Litigation.*** After the Fourteenth Court of Appeals ruled in favor of the City in a lawsuit brought by Proposition 2 (2004) supporters, an appeal to the Texas Supreme Court was made and oral arguments were heard on November 18, 2009. On August 26, 2011, the Texas Supreme Court ruled that the plaintiffs' claims were not ripe for adjudication, vacated the judgments of the Court of Appeals and trial court and dismissed the case for lack of jurisdiction. In a separate lawsuit, a voter sought to invalidate Propositions G and H. That action was dismissed by a state district court; however, the plaintiff appealed the ruling to the First Court of Appeals, which on April 15, 2010 overturned the district court's dismissal of the case and gave the plaintiff an opportunity to amend his pleading to prove standing for the suit. The City appealed such ruling to the Texas Supreme Court, but was denied review on December 16, 2011. The City will continue to aggressively defend such suit.

## **LITIGATION AND REGULATION**

### **Houston Airport System Claims and Litigation**

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

### **Other Claims and Litigation Affecting the City**

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

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

### **Environmental Regulation**

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

### **Air Emissions Controls**

Air quality control measures required by the United States Environmental Protection Agency (the "EPA") and the Texas Commission on Environmental Quality ("TCEQ") may curtail new industrial, commercial and residential development in Houston and adjacent areas. Under the Clean Air Act Amendments of 1990, the eight county Houston-Galveston-Brazoria Area ("HGB Area") has been designated by the EPA as a non-attainment area under the EPA's ozone

standards. Such areas are required to demonstrate progress in reducing ozone concentrations each year until compliance with EPA's standards is achieved. To provide for annual reductions in ozone concentrations, the EPA and the TCEQ have imposed increasingly stringent limitations on emissions of volatile organic compounds and nitrogen oxides ("NOx") from existing stationary sources of air emissions. In addition, any new source of significant air emissions, such as a new industrial plant, must provide for a net reduction of air emissions by arranging for other industries to reduce their emissions by 1.3 times the amount of pollutants proposed to be emitted by the new source. Even though existing air emissions controls are quite stringent, studies have indicated that even more stringent air emissions controls will be necessary in order for the HGB Area to achieve compliance with EPA's existing ozone standard. In January 2010, EPA proposed to lower its existing ozone standard from 0.075 parts per million (ppm) to 0.060 – 0.070 ppm. If EPA ultimately lowers its ozone standard to 0.060 – 0.070 ppm, it will be very difficult for the HGB Area to achieve compliance with the new lower standard. Due to the magnitude of air emissions reductions required as well as shortage of economically reasonable control options, the development of a successful air quality compliance plan has been and continues to be extremely challenging and will inevitably impact a wide cross-section of the business and residential community. Extremely stringent controls on sources of air emissions in the HGB Area could make the Houston area a less attractive location to businesses in comparison to other areas of the country that do not impose similarly stringent air emissions controls. If the HGB Area fails to demonstrate progress in reducing ozone concentrations or fails to meet EPA's ozone standards, EPA may impose a moratorium on the awarding of federal highway construction grants and other federal grants for certain public works construction projects, as well as severe emissions offset requirements on new major sources of hydrocarbon emissions for which construction has not already commenced.

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

## **State Legislation**

Although the City is a home-rule city under the Texas Constitution, it may not adopt ordinances or charter provisions inconsistent with Texas law. The Texas Legislature may enact legislation that (i) materially increases the costs and expenditures of the City or (ii) reduces the ability of the City to collect ad valorem taxes or other revenues described herein. Under the Texas and United States Constitutions, the Texas Legislature may not, however, enact legislation that impairs the City's ability to pay principal of and interest on its indebtedness.

## **RATINGS**

Fitch Ratings, Inc. ("Fitch") and Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P"), have assigned credit ratings to the Series 2012 Bonds of "A+" and "A," respectively. On February 29, 2012, when Fitch confirmed its "A+" credit rating on the Houston Airport System's subordinate lien revenue bonds, it revised its ratings outlook on all subordinate lien bonds (including the Bonds) from stable to negative.

Such ratings reflect only the view of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041; Fitch Ratings, One State Street Plaza, New York, New York 10004. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if, in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2012 Bonds. The City and its Co-Financial Advisors will undertake no responsibility either to bring to the attention of the registered owners of the Series 2012 Bonds any proposed change in or withdrawal of such ratings or to oppose any such revision or withdrawal.

## VERIFICATION OF MATHEMATICAL ACCURACY

The accuracy of the mathematical computations of (i) the adequacy of the maturing principal of and interest earned on the Escrowed Securities for the Refunded Bonds, together with other available funds held in the Refunded Bonds Escrow Fund for the Refunded Bonds, to provide for the payment of the Refunded Bonds and (ii) the “yield” on the Escrowed Securities and on the Series 2012 Bonds, prepared by the Underwriters, will be verified by Grant Thornton LLP, a firm of independent certified public accountants.

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

## TAX MATTERS

### Tax Exemption

In the opinion of Bracewell & Giuliani LLP and Bates & Coleman, P.C., Co-Bond Counsel, under existing law (i) (A) interest on the Series 2012A Bonds is excludable from gross income for federal income tax purposes except for any period a Series 2012A Bond is held by a person who, within the meaning of Section 147(a) of the Internal Revenue Code of 1986, as amended (the “Code”), is a “substantial user” or a “related person” to a “substantial user” of the facilities financed or refinanced with the proceeds of the Series 2012A Bonds, and (B) the Series 2012A Bonds are “private activity bonds” under the Code and, as such, interest on the Series 2012A Bonds is an item of tax preference that is includable in alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on individuals and corporations, and (ii) interest on the Series 2012B Bonds is excludable from gross income for federal income tax purposes and (ii) the Series 2012B Bonds are not “private activity bonds” under the Code, and, as such, interest on the Series 2012B Bonds is not subject to the alternative minimum tax on individuals and corporations, except as described below in the discussion regarding the adjusted current earnings adjustment for corporations.

The Code imposes a number of requirements that must be satisfied for interest on state or local obligations, such as the Series 2012 Bonds, to be excludable from gross income for federal income tax purposes. These requirements include, among other things, limitations on the use of the bond financed project, limitations on the use of bond proceeds and the source of repayment of bonds, limitations on the investment of bond proceeds prior to expenditure, a requirement that excess arbitrage earned on the investment of bond proceeds be paid periodically to the United States and a requirement that the issuer file an information report with the Internal Revenue Service (the “Service”). The City has covenanted in the Ordinance that it will comply with these requirements.

Co-Bond Counsel’s opinion will assume continuing compliance with the covenants of the Ordinance pertaining to those sections of the Code that affect the exclusion from gross income of interest on the Series 2012 Bonds for federal income tax purposes and, in addition, will rely on representations by the City, the City’s Co-Financial Advisors and the Underwriters with respect to matters solely within the knowledge of the City, the City’s Co-Financial Advisors and the Underwriters, respectively, which Co-Bond Counsel have not independently verified. Co-Bond Counsel will further rely on the report (the “Report”) of Grant Thornton LLP, certified public accountants, regarding the mathematical accuracy of certain computations. If the City fails to comply with the covenants in the Ordinance or if the foregoing representations or the Report are determined to be inaccurate or incomplete, interest on the Series 2012 Bonds could become includable in gross income from the date of original delivery of each issue of the Series 2012 Bonds, regardless of the date on which the event causing such inclusion occurs.

The Code imposes an alternative minimum tax on the “alternative minimum taxable income” of an individual, if the amount of such alternative minimum tax is greater than the amount of such individual’s regular income tax. Generally, the alternative minimum tax rate for individuals is 26% of so much of such taxable excess as does not exceed \$175,000 plus 28% of so much of such taxable excess as exceeds \$175,000. The Code also imposes a 20% alternative minimum tax on the “alternative minimum taxable income” of a corporation if the amount of such alternative minimum tax is greater than the amount of the corporation’s regular income tax. Generally, the alternative minimum taxable income of an individual or corporation will include items of tax preference under the Code, such as the amount of interest received on “private activity bonds” issued after August 7, 1986. Accordingly, Co-Bond Counsel’s opinion will state that interest on the Series 2012A Bonds is an item of tax preference that is includable in alternative minimum taxable income for purposes of determining the

alternative minimum tax imposed on individuals and corporations. In addition, the alternative minimum taxable income of a corporation (other than any S corporation, regulated investment company, REIT, or REMIC), includes 75% of the amount by which its “adjusted current earnings” exceeds its other “alternative minimum taxable income.” Because interest on tax-exempt obligations that are not “private activity bonds,” such as the Series 2012B Bonds, is included in a corporation’s “adjusted current earnings,” ownership of the Series 2012B Bonds could subject a corporation to alternative minimum tax consequences.

Except as stated above, Co-Bond Counsel will express no opinion as to any federal, state or local tax consequences resulting from the receipt or accrual of interest on, acquisition, ownership or disposition of, the Series 2012 Bonds.

Co-Bond Counsel’s opinions are based on existing law, which is subject to change. Such opinions are further based on Co-Bond Counsel’s knowledge of facts as of the date thereof. Co-Bond Counsel assumes no duty to update or supplement their opinions to reflect any facts or circumstances that may thereafter come to Co-Bond Counsel’s attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, Co-Bond Counsel’s opinions are not a guarantee of result and are not binding on the Service; rather, such opinions represent Co-Bond Counsel’s legal judgment based upon their review of existing law and in reliance upon the representations and covenants referenced above that they deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given as to whether or not the Service will commence an audit of the Series 2012 Bonds. If an audit is commenced, in accordance with its current published procedures, the Service is likely to treat the City as the taxpayer and the Owners may not have a right to participate in such audit. Public awareness of any future audit of any issue of the Series 2012 Bonds could adversely affect the value and liquidity of such issue of the Series 2012 Bonds regardless of the ultimate outcome of the audit.

## **Additional Federal Income Tax Considerations**

### ***Collateral Tax Consequences***

Prospective purchasers of the Series 2012 Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, and individuals otherwise qualifying for the earned income credit. In addition, certain foreign corporations doing business in the United States may be subject to the “branch profits tax” on their effectively connected earnings and profits, including tax-exempt interest such as interest on the Series 2012 Bonds. These categories of prospective purchasers should consult their own tax advisors as to the applicability of these consequences. Prospective purchasers of the Series 2012 Bonds should also be aware that, under the Code, taxpayers are required to report on their returns the amount of tax-exempt interest, such as interest on the Series 2012 Bonds, received or accrued during the year.

### ***Tax Accounting Treatment of Original Issue Premium***

The issue price of all bonds of each issue of the Series 2012 Bonds exceeds the stated redemption price payable at maturity of such Bonds. Such Series 2012 Bonds (the “Premium Bonds”) are considered for federal income tax purposes to have “bond premium” equal to the amount of such excess. The basis of a Premium Bond in the hands of an initial owner is reduced by the amount of such excess that is amortized during the period such initial owner holds such Premium Bond in determining gain or loss for federal income tax purposes. This reduction in basis will increase the amount of any gain or decrease the amount of any loss recognized for federal income tax purposes on the sale or other taxable disposition of a Premium Bond by the initial owner. No corresponding deduction is allowed for federal income tax purposes for the reduction in basis resulting from amortizable bond premium. The amount of bond premium on a Premium Bond that is amortizable each year (or shorter period in the event of a sale or disposition of a Premium Bond) is determined using the yield to maturity on the Premium Bond based on the initial offering price of such Bond.

The federal income tax consequences of the purchase, ownership and redemption, sale or other disposition of Premium Bonds that are not purchased in the initial offering at the initial offering price may be determined according to rules that differ from those described above. All owners of Premium Bonds should consult their own tax advisors with

respect to the determination for federal, state, and local income tax purposes of amortized bond premium upon the redemption, sale or other disposition of a Premium Bond and with respect to the federal, state, local, and foreign tax consequences of the purchase, ownership, and sale, redemption or other disposition of such Premium Bonds.

### ***Tax Legislative Changes***

Current law may change so as to directly or indirectly reduce or eliminate the benefit of the exclusion of interest on the Series 2012 Bonds from gross income for federal income tax purposes. Any proposed legislation, whether or not enacted, could also affect the value and liquidity of the Series 2012 Bonds. Prospective purchasers of the Series 2012 Bonds should consult with their own tax advisors with respect to any proposed, pending or future legislation.

### **LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS**

Pursuant to Section 1201.041 of the Public Security Procedures Act (Chapter 1201, as amended, Texas Government Code), the Series 2012 Bonds are negotiable instruments governed by Chapter 8, Texas Business and Commerce Code, and are legal and authorized investments for insurance companies, fiduciaries and trustees and for the sinking funds of municipalities and other political subdivisions or public agencies of the State of Texas. The Series 2012 Bonds also are generally eligible to secure deposits of any public funds of Texas municipalities, counties, school districts and Texas State agencies.

The City has made no investigation of any other laws, rules, regulations or investment criteria that might affect the suitability of the Series 2012 Bonds for any of the above purposes or limit the authority of any of the above persons or entities to purchase or invest in the Series 2012 Bonds.

### **CONTINUING DISCLOSURE**

In the Ordinance, the City has made certain agreements regarding the continuing disclosure of information for the benefit of the holders and Beneficial Owners of the Series 2012 Bonds. The City is required to observe such agreements for so long as it remains obligated to advance funds to pay the Series 2012 Bonds. Under the agreements, the City will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified events, whether or not material, to the information repository described below.

#### **Annual Reports**

The City will provide certain updated financial information and operating data to the Municipal Securities Rulemaking Board (the "MSRB") annually. The information to be updated includes quantitative financial information and operating data with respect to the City's Airport System in APPENDIX A and under the schedules listed in APPENDIX D. The City will update and provide this information within six months after the end of each fiscal year. See APPENDIX D relating to the City's limited obligations to update Schedule 9, which contains actuarial information related to the Municipal System Pension Plan.

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

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

## **Certain Event Notices**

The City will also provide notice to the MSRB of any of the following events with respect to the Series 2012 Bonds in a timely manner and not more than 10 Business Days after occurrence of the event: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Series 2012 Bonds, or other material events affecting the tax status of the Series 2012 Bonds; (7) modifications to rights of holders of the Series 2012 Bonds, if material; (8) Series 2012 Bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Series 2012 Bonds, if material; (11) rating changes, (12) bankruptcy, insolvency, receivership, or similar event of the City; (13) the consummation of a merger, consolidation, or acquisition involving the City or the sale of all or substantially all of the assets of the City, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of the trustee, if material. In addition, the City will provide timely notice of any failure by the City to provide information, data or financial statements in accordance with its agreement described above under "Annual Reports." Neither the Ordinance nor the Series 2012 Bonds provide for property securing repayment of the Series 2012 Bonds (other than the subordinate lien on Net Revenues) or appointment of a trustee.

For the purposes of the event numbered (12) in the preceding paragraph, the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the City in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the City, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the City.

## **Availability of Information**

The City has agreed to provide the foregoing information only to the MSRB. The information is expected to be available to holders of the Series 2012 Bonds from the MSRB through the EMMA website at [www.emma.msrb.org](http://www.emma.msrb.org); however, the City makes no representation regarding the availability of such information from the MSRB.

## **Limitations and Amendments**

The City has agreed to update information and to provide notices of the events only as described above. The City has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition or prospects or agreed to update any information that is provided, except as described above. The City makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell the Series 2012 Bonds at any future date. The City disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders of the Series 2012 Bonds may seek a writ of mandamus to compel the City to comply with its agreement.

The City may amend its continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status or type of operations of the City, if the agreement, as amended, would have permitted an underwriter to purchase or sell the Series 2012 Bonds in the offering made hereby in compliance with the Rule and either the holders of a majority in aggregate principal amount of the Outstanding Series 2012 Bonds consent or any person unaffiliated with the City (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the Beneficial Owners of the Series 2012 Bonds. The City may also amend or repeal the agreement if the Commission amends or repeals the applicable provisions of the Rule or a court of final jurisdiction determines that such provisions are invalid, and the City may amend the agreement in its discretion in any other circumstance or manner, but in either case only to the extent that its right to do so

would not prevent the Underwriters from purchasing the Series 2012 Bonds in the offering described herein in compliance with the Rule. If the City amends its agreement, it must include with the next financial information and operating data provided in accordance with its agreement described above under “Annual Reports” an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided. See APPENDIX D relating to the City’s limited obligation to update Schedule 9, which contains actuarial information related to the Municipal System Pension Plan.

### **Compliance with Prior Undertakings**

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

### **No Continuing Disclosure Undertakings by Airlines**

No airline has made any agreement regarding the continuing disclosure of information for the benefit of the holders and Beneficial Owners of the Series 2012 Bonds. However, certain of the certificated major domestic airlines (or their respective parent corporations) are subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended, and thus must file reports and other information with the Commission. See “THE AIRLINE INDUSTRY FINANCIAL INFORMATION.” In addition, pursuant to the Rule, certain airlines may have agreed to continuing disclosure undertakings in connection with the issuance and sale of obligations other than the Series 2012 Bonds. (Continental (now United) entered into a continuing disclosure agreement in connection with the Series 1997 Special Facilities Bonds, Series 1998 Special Facilities Bonds, the Series 2001 Special Facilities Bonds (Terminal E Project) and the Series 2011 Special Facilities Bonds.) In those instances the airlines would have undertaken, in a written agreement or contract for the benefit of the holders of such obligations, to provide to various information repositories certain annual financial information and operating data, including audited financial statements, and to provide notice to such repositories and the MSRB of certain specified material events. Such information is available to securities brokers and others who subscribe to receive the information from such repositories.

## **LEGAL PROCEEDINGS**

The delivery of the Series 2012 Bonds is subject to the approving opinion of the Attorney General of the State of Texas and the opinion of Bracewell & Giuliani LLP and Bates & Coleman, P.C., Co-Bond Counsel for the City, as to the validity of the issuance of the Series 2012 Bonds under the Constitution and laws of the State of Texas. The opinion of Co-Bond Counsel will be based upon an examination of a transcript of certain certified proceedings of the City incident to the issuance and authorization of the Series 2012 Bonds. A copy of the proposed opinion of Bracewell & Giuliani LLP and Bates & Coleman, P.C., to be delivered in connection with the Series 2012 Bonds, is attached to this Official Statement as APPENDIX C.

In their capacity as Co-Bond Counsel, Bracewell & Giuliani LLP, Houston, Texas, and Bates & Coleman, P.C., Houston, Texas, have reviewed the statements and information contained in the Official Statement under the captions and sub-captions “PURPOSE AND PLAN OF FINANCING – The Refunded Bonds,” “THE SERIES 2012 BONDS,” “SECURITY FOR THE SERIES 2012 BONDS” (except for information under the sub-caption “Bondholders’ Remedies”), “COVENANTS AND TERMS OF THE ORDINANCE” (except for the information under the sub-caption “Rate Covenant – Other Factors Impacting Rate Covenant”), “CONTINUING DISCLOSURE” (except for the information under the sub-captions “Compliance With Prior Undertakings” and “No Continuing Disclosure Undertakings by Airlines” as to which no opinion is expressed), and APPENDIX B-1, and Co-Bond Counsel is of the opinion that the statements and information contained therein, insofar as such statements and information summarize certain provisions of the Ordinance and the Series 2012 Bonds, in all material respects fairly and accurately reflect the provisions of the Ordinance and the Series 2012 Bonds; further, Co-Bond Counsel has reviewed the statements and information contained in the Official Statement under the captions and sub-captions “TAX MATTERS” and “LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS,” and Co-Bond Counsel is of the opinion that the statements and information contained therein are correct as to matters of law.

Such firms have not, however, independently verified any of the factual information contained in this Official Statement nor have they conducted an investigation of the affairs of the City or the Houston Airport System for the purpose of passing upon the fairness, accuracy or completeness of this Official Statement. No person is entitled to rely upon such

firms' limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to, the fairness, accuracy or completeness of any of the information contained herein. The fees of Bracewell & Giuliani LLP and Bates & Coleman, P.C., for their services with respect to the Series 2012 Bonds are contingent upon the sale and delivery of the Series 2012 Bonds.

Certain matters will be passed upon by for the City by its Special Disclosure Co-Counsel, Haynes and Boone, LLP, Houston, Texas and Bratton & Associates, Houston, Texas. Certain other legal matters will be passed on for the Underwriters by their counsel, Fulbright & Jaworski L.L.P., Houston, Texas.

Bracewell & Giuliani LLP, Haynes and Boone, LLP, Bratton & Associates, and Bates & Coleman, P.C., represent the Underwriters from time to time in matters unrelated to the issuance of Series 2012 Bonds. Fulbright & Jaworski L.L.P. represents the City from time to time in matters unrelated to the Series 2012 Bonds.

The various legal opinions to be delivered concurrently with the delivery of the Series 2012 Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering a legal opinion, the attorney does not become an insurer or guarantor of that expression of professional judgment, of the transaction opined upon, or the future performance of the parties to the transaction. Nor does the rendering of an opinion guarantee the outcome of any legal dispute that may arise out of the transaction.

#### **CO-FINANCIAL ADVISORS**

First Southwest Company, who in turn has retained TKG & Associates LLC as Co-Financial Advisor, has been retained by the City as Financial Advisor in connection with the issuance of the Series 2012 Bonds and, in such capacity, has assisted the City in the preparation of documents. The Financial Advisor's fee for services rendered with respect to the sale of the Series 2012 Bonds is not contingent upon the issuance and delivery of the Series 2012 Bonds.

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

#### **INDEPENDENT AUDITORS**

The financial statements of the Houston Airport System Fund, as of and for the years ended June 30, 2011 and 2010, included in this Official Statement as APPENDIX A, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report appearing herein.

#### **UNDERWRITING**

Morgan Stanley & Co. LLC ("Morgan Stanley"), as representative and on behalf of all of the Underwriters set forth on the cover page hereof, has agreed to purchase the Series 2012A Bonds, subject to certain conditions, and has agreed to pay therefor a price of \$312,981,624.44 (reflecting the par amount of the Series 2012A Bonds, plus a net premium of \$27,841,085.45, less an underwriting discount of \$1,444,461.01).

Morgan Stanley, as representative and on behalf of all of the Underwriters set forth on the cover page hereof, has agreed to purchase the Series 2012B Bonds, subject to certain conditions, and has agreed to pay therefor a price of \$243,879,014.01 (reflecting the par amount of the Series 2012B Bonds, plus a net premium of \$27,893,103.55, less an underwriting discount of \$1,149,089.54)

Morgan Stanley, an underwriter of the Series 2012 Bonds, has entered into a retail brokerage joint venture with Citigroup Inc. As part of the joint venture, Morgan Stanley will distribute municipal securities to retail investors through the financial advisor network of a separate broker-dealer, Morgan Stanley Smith Barney LLC. This distribution



arrangement became effective on June 1, 2009. As part of this arrangement, Morgan Stanley will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Series 2012 Bonds.

Certain of the Underwriters have entered into distribution agreements with other broker-dealers (that have not been designated by the City as Underwriters) for the distribution of the Bonds at the original issue prices. Such agreements generally provide that the relevant Underwriters will share a portion of its underwriting compensation or selling concession with such broker-dealers.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the issuer, for which they received or will receive customary fees and expenses. In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities and/or instruments of the issuer. The Underwriters and their respective affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

Wells Fargo Securities is the trade name for certain capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association.

#### **FORWARD LOOKING STATEMENTS**

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

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

#### **GENERAL INFORMATION**

All of the summaries of the statutes, ordinances and other related reports set forth herein are made subject to all of the provisions of such documents. The descriptions of the Series 2012 Bonds and the Ordinance herein do not purport to be complete and all such descriptions or references thereto contained in this Official Statement are qualified in their entirety by reference to the complete forms of the Series 2012 Bonds and of the Ordinance. Statements made herein involving estimates or projections, whether or not expressly identified as such, should not be construed to be statements of fact or as representations that such estimates or projections will ever be attained or will even approximate actual results.

Copies of the June 30, 2011 Comprehensive Annual Financial Report of the City of Houston, Texas are available to each of the prospective purchasers of the Series 2012 Bonds upon written request addressed to the office of the City

Controller, P.O. Box 1562, Houston, Texas 77251. THE SERIES 2012 BONDS ARE, HOWEVER, PAYABLE SOLELY FROM NET REVENUES OF THE HOUSTON AIRPORT SYSTEM AND CERTAIN RESERVES ESTABLISHED PURSUANT TO THE ORDINANCE, AND NO IMPLICATION IS MADE THAT ANY OTHER REVENUES OR MONEY OF THE CITY ARE TO BE AVAILABLE FOR THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE SERIES 2012 BONDS. Copies of the Ordinance are available to each of the prospective purchasers of the Series 2012 Bonds upon written request to the Office of the City Attorney, 900 Bagby, 4<sup>th</sup> Floor, Houston, Texas 77002. This document was approved by the City Council of the City.

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**SCHEDULE I**

**SCHEDULE OF REFUNDED BONDS**

**Schedule of AMT Refunded Bonds  
(to be refunded with proceeds of the Series 2012A Bonds)**

**City of Houston, Texas Airport System Subordinate Lien Revenue Bonds, Series 1998B (AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
05/07/2012	2025	\$ 87,800,000	100%
***	***	***	***
05/07/2012	2028	7,190,000	100

**City of Houston, Texas Airport System Subordinate Lien Revenue Bonds, Series 2000A (Non-AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
05/07/2012	2030	\$ 12,525,000	100%

**City of Houston, Texas Airport System Subordinate Lien Revenue Refunding Bonds, Series 2001A (AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
05/07/2012	2016	\$ 3,235,000	100%
05/07/2012	2017	3,410,000	100
***	***	***	***
05/07/2012	2019	7,365,000	100
***	***	***	***
05/07/2012	2021	8,145,000	100

**City of Houston, Texas Airport System Subordinate Lien Revenue Bonds, Series 2002A (AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
07/01/2012	2018	\$ 1,825,000	100%
07/01/2012	2019	4,810,000	100
07/01/2012	2020	5,065,000	100
07/01/2012	2021	5,350,000	100
07/01/2012	2022	5,280,000	100
***	***	***	***
05/07/2012	2027	30,655,000	100
***	***	***	***
07/01/2012	2032	127,060,000*	100

\* Represents a partial refunding of a term bond. The mandatory sinking fund redemption payments for such term bond will be reduced by the amount reflected, applied first to redemption payments due earliest.

**Schedule of Non-AMT Refunded Bonds  
(to be refunded with proceeds of the Series 2012B Bonds)**

**City of Houston, Texas Airport System Subordinate Lien Revenue Bonds, Series 1998C (Non-AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
05/07/2012	2028	\$ 76,845,000	100%

**City of Houston, Texas Airport System Subordinate Lien Revenue Bonds, Series 2002B (Non-AMT)**

<u>Redemption Date</u>	<u>Scheduled Maturity (July 1)</u>	<u>Refunded Principal Amount</u>	<u>Redemption Price</u>
07/01/2012	2021	\$ 5,380,000	100%
07/01/2012	2022	5,285,000	100
***	***	***	***
07/01/2012	2027	30,670,000	100
***	***	***	***
07/01/2012	2032	119,785,000*	100

\* Represents a partial refunding of a term bond. The mandatory sinking fund redemption payments for such term bond will be reduced by the amount reflected, applied first to redemption payments due earliest.

**APPENDIX A**

**AIRPORT SYSTEM FUND FINANCIAL STATEMENTS**

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# AIRPORT SYSTEM FUND

An Enterprise Fund of  
The City of Houston, Texas



## Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2011



Prepared by Office  
of the City Controller

Ronald C. Green  
City Controller

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**Airport System Fund**  
An Enterprise Fund of the  
**City of Houston, Texas**  
Comprehensive Annual  
Financial Report

Fiscal Year Ended June 30, 2011

Prepared by:  
Office of City Controller

Ronald C. Green  
City Controller

Carl Medley  
Deputy Director Controller

Becky Moores, CPA  
Houston Airport System

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**COMPREHENSIVE ANNUAL FINANCIAL REPORT****TABLE OF CONTENTS**

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<b>INTRODUCTORY SECTION (unaudited)</b>	<b>Page</b>
Airport Locations and Service Area	i
Certificate of Achievement	ii
Transmittal Letter	iii
List of Principal Officers	vii
Organizational Chart	viii
 <b>FINANCIAL SECTION</b>	
Independent Auditors' Report	1
Management's Discussion and Analysis (unaudited)	3
Financial Statements:	
Statement of Net Assets	10
Statements of Revenues, Expenses and Changes in Net Assets	12
Statements of Cash Flows	13
Notes to the Financial Statements	17
Required Pension System and Other Post-Employment (OPEB) cost and Net OPEB (Obligation) Asset Supplementary Information (unaudited)	51
 <b>STATISTICAL SECTION (unaudited)</b>	
Total Annual Revenues and Total Expenses Charts	53
Total Annual Revenues, Expenses and Change in Net Assets	54
Pledged Revenues	55
Outstanding Debt	57
Summary of Certain Fees and Charges	58
Passenger Statistics	59
Passenger Statistics by Carrier	60
Originating Passenger Enplanements	62
Aircraft Operations and Landing Weight	63
Performance Measures	64
Airport Information	65
Employee Staffing by Function	67
Service Area / Service Area Population / Largest Private Employee	68

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COMPREHENSIVE ANNUAL FINANCIAL REPORT

**INTRODUCTORY SECTION**



# HOUSTON AIRPORT SYSTEM



	Metropolitan Statistical Area (MSA) of Houston - Sugar Land - Baytown, TX includes 10 counties.
	Consolidated Statistical Area (CSA) of Houston - Baytown - Huntsville, TX adds both Matagorda & Walker Counties



# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## City of Houston, Texas Airport System Fund

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2010

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



President

Executive Director





Office of the City Controller  
City of Houston  
Texas

December 2, 2011

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

I am pleased to present you with the Comprehensive Annual Financial Report (CAFR) for the City of Houston, Texas, Airport System Fund (the Fund) for the fiscal year ended June 30, 2011, including the independent auditor's report. The Controller's Office and the Houston Airport System share responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the Fund.

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

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

### **The Reporting Entity and Its Services**

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

The Fund is an enterprise fund of the City and is included in the City's Comprehensive Annual Financial Report, which is a matter of public record. An enterprise fund is used to account for services provided to the general public on a continuing basis with costs recovered primarily through user charges. The City's Airport System includes the following: George Bush Intercontinental Airport (Intercontinental); William P. Hobby Airport (Hobby); and Ellington Airport. Continental Airlines, Inc., which merged with United Airlines on October 1, 2010, is the dominant air carrier operating at Intercontinental and Southwest Airlines, Inc., which purchased Airtran Airways on May 2, 2011, is the dominant air carrier operating at Hobby.

## **Economic Conditions and Major Initiatives**

### **Economic conditions**

Houston is classified as a large air traffic hub by the Federal Aviation Administration (FAA). Based on total U.S. passenger traffic for calendar year 2010, Intercontinental and Hobby ranked seventh and fortieth, respectively, among U.S. airports. Intercontinental, which opened in 1969, is the City's dominant air carrier facility and is located approximately 22 miles north of the City's central business district on property comprising approximately 10,000 acres. Hobby is located approximately seven miles southeast of the central business district on approximately 1,500 acres. Ellington Airport is situated approximately 15 miles southeast of the central business district on approximately 2,000 acres, a portion of which was conveyed to the City by the federal government on July 1, 1984.

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

Key factors that will affect future airline traffic at the Houston Airport System include (1) the growth in the population and economy of the service region, (2) national and international economic conditions, (3) airline economics and air fares, (4) the availability and price of aviation fuel, (5) airline service and route networks, (6) the capacity of the air traffic control system and (7) the capacity of the airports themselves. The national and global economic conditions have impacted the Houston Airport System. This impact was felt most during fiscal year 2009 as HAS recorded a decline in passengers of 8.3%. During fiscal year 2010, HAS recorded positive passenger growth of 2.2% and continued on a path of growth in fiscal year 2011, achieving a 1.7% increase.

### **Capital Improvement Program**

The Houston Airport System's (HAS) five-year Capital Improvement Plan (CIP) for 2012-2016 had appropriation requirements of approximately \$874 million, with 31% of the appropriations planned for fiscal year 2012 as of June 30, 2011. Future improvements will be funded with airport funds, remaining proceeds from bond issues, FAA grants and passenger facility charges. HAS continually reviews its CIP program to address changing economic and commercial activity levels.

At Intercontinental, HAS has a new special facilities lease agreement with Continental Airlines which requires it to make certain investments to redevelop Terminal B. These Terminal B improvements and planned improvements at Terminal D represent 53% of the CIP. Infrastructure improvements in support of the terminals represent approximately 18% of the CIP. Preliminary design work on construction of a potential midfield taxiway has been programmed as well as two taxiway rehabilitation projects. Additional Master Plan projects will be incorporated into the CIP as demand triggers activity levels or as infrastructure must be replaced.

Hobby Airport's major projects are completing the terminal rehabilitation and parking garage renovations. The final phase of the landside terminal reconstruction began in April 2009 and the remaining work requires reconstruction of the upper u-ramp in front of the terminal. HAS continues to plan for and to assess the feasibility of a new parking garage.

At Ellington Airport, construction of a Taxiway K extension was completed in fiscal year 2011.

## **Financial Information**

### **Accounting systems and budgetary controls**

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

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

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

## **Other Information**

### **Independent Audit**

An independent auditor audits the financial statements of the Airport System Fund each year. Deloitte & Touche LLP has performed the fiscal year 2011 and 2010 audits. The financial section of this report includes the independent auditors' report on the basic financial statements.

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

## **Awards/Acknowledgments**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to City of Houston, Texas, Airport System Fund for its comprehensive annual financial report for the fiscal year ended June 30, 2010. This was the 17<sup>th</sup> consecutive year that the Airport System Fund has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

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

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

Respectfully submitted,

A handwritten signature in black ink, reading "Ronald C. Green". The signature is written in a cursive style with a large, sweeping flourish at the end.

Ronald C. Green  
City Controller

**INTRODUCTORY SECTION  
LIST OF PRINCIPAL OFFICERS**

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**ELECTED OFFICIALS AS OF JUNE 30, 2011:**

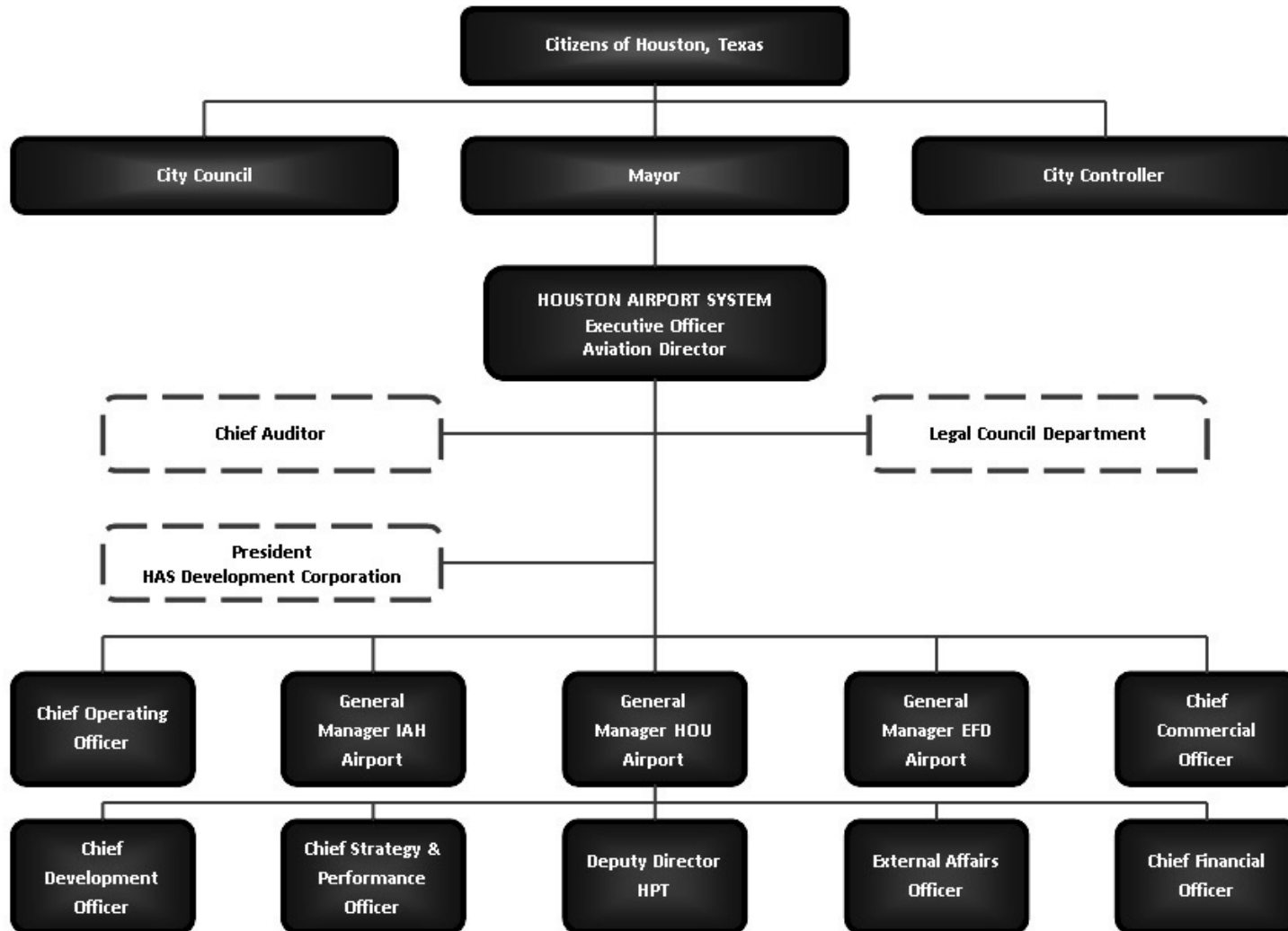
Mayor----- Annise D. Parker  
Controller -----Ronald C. Green  
Councilmember, At-Large, Position 1 ----- Stephen C. Costello  
Councilmember, At-Large, Position 2 ----- Sue Lovell  
Councilmember, At-Large, Position 3 -----Melissa Noriega  
Councilmember, At-Large, Position 4 ----- C.O. "Brad" Bradford  
Councilmember, At-Large, Position 5 -----Jolanda "Jo" Jones  
Councilmember, District A----- Brenda Stardig  
Councilmember, District B----- Jarvis Johnson  
Councilmember, District C ----- Anne Clutterbuck  
Councilmember, District D ----- Wanda Adams  
Councilmember, District E----- Mike Sullivan  
Councilmember, District F-----Al Hoang  
Councilmember, District G ----- Oliver Pennington  
Councilmember, District H ----- Edward Gonzalez  
Councilmember, District I-----James G. Rodriguez

**HOUSTON AIRPORT SYSTEM (a department of the City of Houston)  
AS OF JUNE 30, 2011:**

Aviation Director, Executive Officer -----Mario Diaz  
Deputy Director, Chief Commercial Officer-----Ian Wadsworth  
Deputy Director, Chief Financial Officer -----Kirk Rummel  
Deputy Director, Chief Development Officer-----Lance Lyttle  
Deputy Director, Chief Strategy & Performance Officer-----Eric Potts  
Acting Deputy Director, HPT-----Dolores Rodgers  
External Affairs Officer-----Saba Abashawl  
General Manager, Intercontinental Airport----- Mary Case  
General Manager, Hobby Airport-----Perry Miller  
General Manager, Ellington Airport----- Brian Rinehart

INTRODUCTORY SECTION

ORGANIZATIONAL CHART AS OF JUNE 30, 2011



COMPREHENSIVE ANNUAL FINANCIAL REPORT

**FINANCIAL SECTION**







Deloitte & Touche LLP  
Suite 4500  
1111 Bagby Street  
Houston, TX 77002-4196  
USA

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

## **INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying statements of net assets of the Airport System Fund (the "Fund") of the City of Houston, Texas (the "City") as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the Airport System Fund and do not purport to, and do not, present fairly the financial position of the City of Houston, Texas as of June 30, 2011 and 2010, the changes in its net assets, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Airport System Fund of the City of Houston, Texas as of June 30, 2011 and 2010, and its change in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis (pages 3-9); Pension System Supplementary Information (page 51) and Other Post Employment Benefits Schedule of Funding Progress (page 51) are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of City's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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

*Deloitte & Touche LLP*

December 2, 2011

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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As management of the Airport System Fund, we offer readers of the Airport System Fund's financial statements this narrative overview and analysis of the financial activities of the Airport System Fund for the fiscal year ended June 30, 2011. Please read the Management's Discussion and Analysis (unaudited) section in conjunction with the financial statements and the notes to the financial statements, which follow this section. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

**Financial Highlights**

The Airport System Fund's net assets decreased by \$6.5 million or 0.5% during fiscal year 2011 and increased by \$58.0 million or 4.2% during fiscal year 2010.

Operating income decreased by \$34.3 million due to an increase in operating expenses of \$38.1 million or 9.3% with an increase in operating revenue of \$3.8 million or 0.9%. In fiscal year 2010, operating income decreased \$10.6 million or 133.7%, due to an increase in operating expenses of \$31.4 million or 8.3% with an increase in operating revenue of \$20.8 million or 5.4%.

Interest revenue decreased by \$20.8 million or 68.2% in fiscal year 2011 and decreased by \$6.8 million or 18.3% in fiscal year 2010.

Total Operating expenses increased by \$38.1 million or 9.3% in fiscal year 2011 and increased by \$31.4 million or 8.3% in fiscal year 2010. Depreciation expense decreased \$1.1 million or 0.7% in fiscal year 2011 and increased \$27.6 million or 20.2% in fiscal year 2010. Maintenance and operating expenses increased \$39.3 million or 16.0% in fiscal year 2011 and increased \$3.7 million or 1.6% in fiscal year 2010.

The Fund had a net loss before capital contributions of \$50.6 million, compared to a net income before capital contributions of \$6.5 million in fiscal year 2010.

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Airport System Fund's financial statements. The Airport System Fund's financial statements consist of the following components: this management's discussion and analysis, the financial statements, the notes to the financial statements, and required supplementary information. The notes are essential to a full understanding of this report. In addition, a statistical section is included for further analysis. A fund is a group of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. An enterprise fund is used to account for a business-like activity within a government. The Airport System Fund is an enterprise fund of the City of Houston. The Houston Airport System, consisting of George Bush Intercontinental Airport (Intercontinental), William P. Hobby Airport (Hobby), and Ellington Airport, is managed and operated as a department of the City. The Airport System Fund is also included in the City of Houston's Comprehensive Annual Financial Report (CAFR).

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

The statement of revenues, expenses and changes in net assets presents information showing how the Fund's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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

**Net Assets**

Total net assets at June 30, 2011 were \$1,430.5 million, a 0.5% decrease from June 30, 2010. Total net assets at June 30, 2010 were \$1,437.0 million, a 4.2% increase from June 30, 2009.

**NET ASSETS**  
**JUNE 30, 2011, JUNE 30, 2010, and JUNE 30, 2009**  
(in thousands)

	June 30, 2011	June 30, 2010	June 30, 2009
Current assets	\$ 1,068,806	\$ 1,072,728	\$ 793,641
Noncurrent assets	8,502	9,389	5,375
Capital assets	<u>3,007,398</u>	<u>3,055,976</u>	<u>2,958,723</u>
Total assets	<u>4,084,706</u>	<u>4,138,093</u>	<u>3,757,739</u>
Current liabilities	171,876	177,173	167,817
Long term liabilities	<u>2,482,340</u>	<u>2,523,961</u>	<u>2,210,922</u>
Total liabilities	<u>2,654,216</u>	<u>2,701,134</u>	<u>2,378,739</u>
Net assets invested in capital			
assets, net of related debt	663,917	701,767	790,731
Restricted net assets	<u>766,573</u>	<u>735,192</u>	<u>588,269</u>
Total net assets	<u>\$ 1,430,490</u>	<u>\$ 1,436,959</u>	<u>\$ 1,379,000</u>

Approximately half of the Fund's total net assets (46.4% in fiscal year 2011; 48.8% in fiscal year 2010) reflects net assets invested in capital assets (e.g., land, buildings, runways, equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Fund uses these capital assets to operate the airports; consequently, these assets are not available for future spending. Although the Fund's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from airport revenue or other sources procured by the airport fund, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Fund's net assets (53.6% in fiscal year 2011; 51.2% in fiscal year 2010) represents resources that are subject to external restrictions on how they may be used. Most of these restrictions are due to covenants made to the holders of the Airport System Fund's revenue bonds within ordinances passed by City Council. These covenants further require that any unrestricted net assets

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

carried in cash and cash equivalents at the end of the fiscal year be restricted for future capital improvements.

**Changes in Net Assets**

From July 1, 2010 to June 30, 2011, net assets of the Airport System Fund decreased by \$6.5 million or 0.5%. From July 1, 2009 to June 30, 2010, net assets increased by \$58.0 million or 4.2%.

**CHANGES IN NET ASSETS**  
**JUNE 30, 2011, JUNE 30, 2010, AND JUNE 30, 2009**  
(in thousands)

	<u>June 30,</u> <u>2011</u>	<u>June 30,</u> <u>2010</u>	<u>June 30,</u> <u>2009</u>
Operating revenue:			
Landing area fees	\$ 90,384	\$ 94,165	\$ 82,823
Rentals, building and ground	181,182	182,105	174,433
Parking and concessions	134,985	125,999	122,701
Other	3,851	4,310	5,800
Total operating revenues	<u>410,402</u>	<u>406,579</u>	<u>385,757</u>
Nonoperating revenue:			
Interest on investments	9,700	30,487	37,332
Passenger facility charges	63,138	66,383	32,398
Other nonoperating	3,409	7,525	1,093
Total nonoperating revenues	<u>76,247</u>	<u>104,395</u>	<u>70,823</u>
Total revenues	<u>486,649</u>	<u>510,974</u>	<u>456,580</u>
Operating expenses:			
Maintenance and operating	284,307	245,051	241,303
Depreciation	163,054	164,186	136,554
Total operating expenses	<u>447,361</u>	<u>409,237</u>	<u>377,857</u>
Nonoperating expenses:			
Interest expense	91,133	95,037	94,396
(Gain) / Loss on disposal of assets	(1,241)	198	(1,020)
Total nonoperating expenses	<u>89,892</u>	<u>95,235</u>	<u>93,376</u>
Total expenses	<u>537,253</u>	<u>504,472</u>	<u>471,233</u>
Excess (deficit) before contributions	(50,604)	6,502	(14,653)
Capital contributions	44,135	51,457	70,936
Change in net assets	(6,469)	57,959	56,283
Net assets, July 1	1,436,959	1,379,000	1,322,717
Net assets, June 30	<u>\$ 1,430,490</u>	<u>\$ 1,436,959</u>	<u>\$ 1,379,000</u>

Operating revenues increased by \$3.8 million or 0.9% for fiscal year 2011. Enplaned and deplaned passenger volume increased for the second consecutive year despite continuing difficult economic conditions, growing 1.7% in fiscal year 2011 after a 2.2% increase in fiscal year 2010. Detailed passenger statistics and comparative rates and charges can be found in the statistical section of this report.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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Operating expenses increased by \$38.1 million or 9.3% in fiscal year 2011. Most of this increase was due to \$2.2 million increase in total payroll costs, a \$2.9 million increase in Interfund Police Service Costs, \$8.8 million of Hurricane Ike repair costs, a \$9.2 million write-off of halted projects and a \$13.8 million write-off of planning and construction costs not meeting capitalization criteria. Base salary expense increased \$2.2 million or 2.0% partially as a result of a Houston Organization of Public Employees (HOPE) Union 4.2% salary increase. Operating expenses in fiscal year 2010 increased by \$31.4 million or 8.3%. Depreciation expense increased by \$27.6 million or 20.2% and base salary expense increased \$3.7 million or 3.5% in fiscal year 2010 partially as a result of a Houston Organization of Public Employees (HOPE) Union 4.2% salary increase.

Capital contributions in fiscal year 2011 decreased by \$7.3 million or 14.2% over fiscal year 2010. This decrease is partly due to a 10 year FAA Letter of Intent on runway 8L 26R ending in fiscal year 2010. In fiscal year 2010, capital contributions decreased by \$19.5 million or 27.5%. This decrease is the result of the Airport System fund receiving fewer entitlement grants due to PFC charges being received at Intercontinental for a first full year (PFC program was implemented at Intercontinental Airport in December, 2008).

Non-operating revenue decreased by \$28.1 million or 27.0% in fiscal year 2011. Passenger Facility Charges (PFC's) decreased \$3.2 million or 4.9% from fiscal year 2010 because HAS transitioned from a FAA cash basis of reporting PFC's to an accrual basis in fiscal year 2011. Interest revenue, which is included in non-operating revenue, decreased by \$20.8 million or 68.2%. The decrease is primarily explained by an apportioned \$16.1 million of unrealized investment losses from the city. The \$16.1 million represents 1.6% of the total Houston Airport System pooled investment portfolio. In fiscal year 2010, non-operating revenue increased by \$33.6 million or 47.4%. This increase was due to IAH PFC charges being reported for the first full year in 2010.

Interest expense decreased by \$3.9 million or 4.1%.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)****Capital Assets**

The Airport System Fund's investment in capital assets amounts to \$3.0 billion at June 30, 2011, a decrease of \$48.6 million, or 1.6%, from June 30, 2010. Capital assets at June 30, 2010 were \$3.1 billion which was an increase of \$97.3 million, or 3.3%, from June 30, 2009.

**CAPITAL ASSETS**  
**JUNE 30, 2011, JUNE 30, 2010, AND JUNE 30, 2009**  
**(net of accumulated depreciation in thousands)**

	June 30, 2011	June 30, 2010	June 30, 2009
Land	\$ 210,091	\$ 209,738	\$ 209,311
Rights & Intangibles - Non-Depreciable	7,016	-	-
Buildings and building improvements	1,472,872	1,362,503	1,411,348
Improvements other than buildings	950,859	965,506	1,000,178
Equipment	52,647	47,678	51,890
Rights & Intangibles - Amortizable	635	-	-
Construction work in progress	313,278	470,551	285,996
	<u>\$ 3,007,398</u>	<u>\$ 3,055,976</u>	<u>\$ 2,958,723</u>

The major on-going capital projects during fiscal year 2011 at George Bush Intercontinental Airport included the rehabilitation of Taxiway WA and WB, extension of the automated people mover system to Terminal A, the Terminal C garage upgrades and planning for the redevelopment of Terminal B and Terminal D. Projects at William P. Hobby Airport included terminal building redevelopment, parking structure rehabilitation and planning for various security upgrades. System-wide projects across the Houston Airport System included ongoing GIS development and pavement replacement for airfields and roadways at all three airports. For more information on Capital Assets, please refer to Note 4 of the financial statements.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)****Debt**

At the end of the current fiscal year, the Airport System Fund had total debt of \$2.4 billion, which represents outstanding senior and subordinate lien revenue bonds net of unamortized discounts, premiums and deferred amount and an inferior lien contract, all secured solely by Airport Fund revenues. The \$6.0 million senior lien commercial paper was repaid in July 2010 and no commercial paper is outstanding as of 06/30/2011. In addition, the Fund is responsible for \$2.0 million of pension obligation bonds. At the end of fiscal years 2011 and 2010, the Fund had total debt of \$2.4 billion and \$2.5 billion respectively.

**OUTSTANDING DEBT**  
**JUNE 30, 2011, JUNE 30, 2010, AND JUNE 30, 2009**  
(in thousands)

	<u>June 30, 2011</u>	<u>June 30, 2010</u>	<u>June 30, 2009</u>
<b>Senior lien debt:</b>			
Long-term revenue bonds payable	\$ 449,660	\$ 449,660	\$ -
Unamortized discounts and premium	(1,255)	(1,367)	-
Commercial paper	-	6,000	93,000
Total senior lien debt	<u>448,405</u>	<u>454,293</u>	<u>93,000</u>
<b>Subordinate lien debt:</b>			
Current maturities-revenue bonds	52,285	47,335	40,840
Long-term revenue bonds payable	1,939,075	1,990,430	2,042,415
Unamortized discounts, premium, or deferred amounts on refunding	(29,716)	(29,545)	(30,835)
Total subordinate lien debt	<u>1,961,644</u>	<u>2,008,220</u>	<u>2,052,420</u>
<b>Inferior lien debt:</b>			
Current maturities-contract	4,535	4,305	4,085
Long-term contract payable	32,895	37,430	41,735
Total inferior lien debt	<u>37,430</u>	<u>41,735</u>	<u>45,820</u>
<b>Other debt:</b>			
Pension obligation bonds	2,006	2,006	2,006
Total other debt	<u>2,006</u>	<u>2,006</u>	<u>2,006</u>
Total outstanding debt	<u>\$ 2,449,485</u>	<u>\$ 2,506,254</u>	<u>\$ 2,193,246</u>

Total outstanding debt decreased \$56.8 million or 2.3% during fiscal year 2011 due to principal repayment. During fiscal year 2010, the outstanding debt increased \$313.0 million or 14.3%. The increase in fiscal year 2010 was partly attributable to the issuance of City of Houston, Texas, Airport System Senior Lien Revenue and Refunding Bonds, Series 2009A. For a complete list of outstanding debt and required debt service, please refer to note 6 to the financial statements.



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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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The underlying ratings of the Airport System Fund's obligations for fiscal year 2011:

	<b>As of June 30, 2011</b>	
	<b>Senior</b>	<b>Subordinate</b>
Standard & Poor's	AA-	A
Moody's	Aa3	A2
Fitch's	Not Rated	A+

**Requests for Information**

This financial report is designed to provide a general overview of the City of Houston, Texas Airport System Fund finances for all of those with an interest in the fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the City Controller, 901 Bagby, 8<sup>th</sup> Floor, P.O. Box 1562, Houston, Texas 77251-1562.

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**STATEMENTS OF NET ASSETS (in thousands)**  
**JUNE 30, 2011 AND 2010**


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	<u>2011</u>	<u>2010</u>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 1,028,278	\$ 1,018,843
Accounts Receivable (net of allowance for doubtful accounts of \$526 in 2011 and \$1,427 in 2010)	22,174	24,976
Due from City of Houston	953	10,832
Inventory	2,549	2,490
Prepaid insurance	2,207	2,305
Due from other governments - grants receivable	5,967	6,476
Restricted assets - investments	<u>6,678</u>	<u>6,806</u>
Total current assets	<u>1,068,806</u>	<u>1,072,728</u>
Noncurrent assets		
Deferred charges	<u>8,502</u>	<u>9,389</u>
Capital Assets		
Land	210,091	209,738
Intangibles	7,679	0
Buildings, improvements and equipment	4,255,434	3,998,824
Construction in progress	<u>313,278</u>	<u>470,551</u>
Total capital assets	4,786,482	4,679,113
Less accumulated depreciation	<u>(1,779,084)</u>	<u>(1,623,137)</u>
Net capital assets	<u>3,007,398</u>	<u>3,055,976</u>
Total noncurrent assets	<u>3,015,900</u>	<u>3,065,365</u>
<b>Total assets</b>	<u>\$ 4,084,706</u>	<u>\$ 4,138,093</u>

(continued)

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**STATEMENTS OF NET ASSETS (in thousands)**  
**JUNE 30, 2011 AND 2010**


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	<u>2011</u>	<u>2010</u>
<b>Liabilities</b>		
Current Liabilities		
Accounts payable	\$ 8,953	\$ 6,667
Accrued payroll liabilities	4,591	4,151
Due to City of Houston	1,208	538
Advances and deposits	1,422	1,492
Deferred revenue	9,870	7,830
Claims for workers' compensation	797	910
Compensated absences	4,865	5,113
Revenue bonds payable	52,285	47,335
Inferior lien contract payable	4,535	4,305
Commercial paper payable	0	6,000
Accrued interest payable	53,897	54,958
Contracts and retainages payable	29,453	37,874
	<u>171,876</u>	<u>177,173</u>
Total current liabilities		
Long-term liabilities		
Revenue bonds payable, net	2,357,764	2,409,178
Inferior lien contract, net	32,895	37,430
Pension obligation bonds payable	2,006	2,006
Claims for workers compensation	1,830	2,428
Compensated absences	7,156	5,717
Net pension obligation payable	42,083	37,205
Other post employment benefits	38,275	29,997
Other long-term liabilities	331	0
	<u>2,482,340</u>	<u>2,523,961</u>
Total long-term liabilities		
<b>Total liabilities</b>		
	<u>2,654,216</u>	<u>2,701,134</u>
<b>Net assets</b>		
Invested in capital assets, net of related debt	663,917	701,767
Restricted net assets		
Restricted for debt service	164,162	156,341
Restricted for maintenance and operations	43,320	42,405
Restricted for renewal and replacement	10,000	10,000
Restricted for capital improvements	549,091	526,446
	<u>1,430,490</u>	<u>1,436,959</u>
<b>Total net assets</b>		

The accompanying notes are an integral part of the financial statements

**CITY OF HOUSTON, TEXAS****AIRPORT SYSTEM FUND****STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS****(in thousands)****FOR YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>Operating Revenues</b>		
Landing area fees	\$ 90,384	\$ 94,165
Rentals, building and ground area	181,182	182,105
Parking	70,681	70,127
Concessions	64,304	55,872
Other	3,851	4,310
	<u>410,402</u>	<u>406,579</u>
<b>Operating Expenses</b>		
Maintenance and operating	284,307	245,051
Depreciation	163,054	164,186
	<u>447,361</u>	<u>409,237</u>
<b>Operating income</b>	<u>(36,959)</u>	<u>(2,658)</u>
<b>Nonoperating revenues (expenses)</b>		
Interest revenue	9,700	30,487
Interest expense	(91,133)	(95,037)
Gain / (Loss) on disposal of assets	1,241	(198)
Passenger facility charges	63,138	66,383
Other revenue	3,409	7,525
	<u>(13,645)</u>	<u>9,160</u>
<b>Income/(loss) before capital contributions</b>	(50,604)	6,502
Capital contributions	44,135	51,457
<b>Change in net assets</b>	(6,469)	57,959
<b>Total net assets, July 1</b>	<u>1,436,959</u>	<u>1,379,000</u>
<b>Total net assets, June 30</b>	<u>\$ 1,430,490</u>	<u>\$ 1,436,959</u>

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

**CITY OF HOUSTON, TEXAS**

**AIRPORT SYSTEM FUND**

**STATEMENTS OF CASH FLOWS (in thousands)  
FOR YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>Cash flows from operating activities</b>		
Receipts from customers	\$ 411,472	\$ 391,367
Payments to employees	(96,988)	(95,396)
Payments to suppliers	(101,002)	(100,890)
Payments to the City of Houston	(36,807)	(52,387)
Claims paid	(796)	(910)
Other revenues	5,709	5,775
Net cash provided by operating activities	<u>181,588</u>	<u>147,559</u>
<b>Cash flows from investing activities</b>		
Sale of investments	14,809	9,043
Purchase of investments	(14,681)	(9,022)
Gain (loss) on sale of nonpooled stock	125	-
Interest income on investments	9,575	30,487
Net cash provided by investing activities	<u>9,828</u>	<u>30,508</u>
<b>Cash flows from noncapital financing activities</b>		
Interest expense pension obligation bonds	(106)	(106)
Deferred charges on future debt issuance	(386)	468
Net cash (used for) provided by noncapital financing activities	<u>(492)</u>	<u>362</u>
<b>Cash flows from capital and related financing activities</b>		
Retirement of revenue bonds	(47,235)	(45,490)
Proceeds (use of cash) from issuance of debt	92,900	443,288
Refunding of revenue bonds	(92,900)	-
Interest expense on debt	(111,972)	(98,822)
Retirement of inferior lien contract	(4,305)	(4,085)
Retirement of commercial paper	(6,000)	(87,000)
Passenger facility charges	63,138	66,383
Advances and deposits	-	(337)
Contributed capital	44,622	55,304
Acquisition of capital assets	(119,737)	(256,026)
Net cash (used for) capital and related financing activities	<u>(181,489)</u>	<u>73,215</u>
Net increase (decrease) in cash and cash equivalents	9,435	251,644
Cash and cash equivalents, beginning of year	<u>1,018,843</u>	<u>767,199</u>
<b>Cash and cash equivalents, end of the year</b>	<u>\$ 1,028,278</u>	<u>\$ 1,018,843</u>

(continued)

**STATEMENTS OF CASH FLOWS (in thousands)**  
**FOR YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>Noncash transactions</b>		
Capitalized interest expense	\$ 21,912	\$ 16,496
Donated assets	(22)	(427)
Capital additions included in liabilities	(8,421)	(9,462)
Loss (gain) on disposal of assets	(1,241)	198
	<u>\$ 12,228</u>	<u>\$ 6,805</u>
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income	\$ (36,959)	\$ (2,658)
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	163,054	164,186
Capital improvement plan expense	21,746	-
Other revenues	3,409	7,525
Changes in assets and liabilities		
Accounts receivable	1,402	(21,529)
Due from the City of Houston	9,879	(9,559)
Due from other governments	-	549
Inventory and prepaid insurance	39	201
Accounts payable	2,302	(8,751)
Accrued payroll liabilities	440	421
Due to the City of Houston	670	202
Advances and deposits	1,970	4,018
Other post-employment benefits	4,878	3,876
Net pension obligation payable	8,278	9,349
Claims for workers' compensation	(711)	(1,098)
Compensated absences	1,191	827
	<u>\$ 181,588</u>	<u>\$ 147,559</u>

The accompanying notes are an integral part of the financial statements

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**NOTES TO THE FINANCIAL STATEMENTS**

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**1. Reporting Entity**

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

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

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

**2. Summary of Significant Accounting Policies****Basis of Accounting**

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

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

In March 2009, the GASB issued Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions". This statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010. The City has implemented GASB No. 54 in this annual report and it had no impact.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

In December 2009, the GASB issued Statement No. 57, "OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans". This statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2011. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

In June 2010, the GASB issued Statement No. 59, "Financial Instruments Omnibus". This statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010. The City has implemented GASB No. 59 in this annual report.

In November 2010, the GASB issued 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 are effective for financial statements for periods beginning after December 15, 2011. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

In November 2010, the GASB issued 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 City 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 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 (FASB) Statements and Interpretations; Accounting Principles Board Opinions; Accounting Research Bulletins of the American Institute of Certified Public Accountants (AICPA) Committee on Accounting Procedure. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The City has not determined the impact, if any, upon its financial position, results of operations or cash flows upon adoption.

**Inventories of Material and Supplies**

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

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**NOTES TO THE FINANCIAL STATEMENTS**

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

The Fund defines capital assets as assets with an initial cost of more than \$5,000. Acquired or constructed property is recorded at historical cost or estimated historical cost. Contributed property is recorded at the estimated fair value on the date received. Construction costs (excluding land and equipment) are added to construction work-in-progress until the assets are placed in service and are depreciated following completion. Depreciation on equipment begins in the year of acquisition. Interest costs on funds borrowed to finance the construction of capital assets are capitalized when the costs materially exceed interest earnings on related revenue bond proceeds. \$21.9 million in interest costs was capitalized for the year ended June 30, 2011. \$16.5 million was capitalized for the year ended June 30, 2010.

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

**Compensated Absences**

Full-time civilian employees of the City are eligible for 10 days of vacation leave per year. After four years, employees receive 15 days. The amount of vacation time gradually increases after that, reaching a maximum of 25 days per year after 18 years of service. Employees may accumulate up to 90 days of vacation leave (45 days for employees hired after December 31, 1999). Upon termination or retirement, employees are paid for unused vacation leave based on the average rate of pay during the employee's highest paid 60 days of employment. Part-time employees (those working less than 30 hours per week) are not eligible for vacation leave benefits.

The majority of full-time civilian employees are covered under the compensatory sick leave plan and receive a leave time allowance of 2.5 hours per payroll period (bi-weekly) up to a maximum of 65 hours per year. Employees who use fewer than 65 hours during the benefit year will receive a match of additional hours equal to the number of hours accrued minus the number of hours used. Once an employee's balance has reached 1,040 hours, no additional match for unused hours is given. Upon termination, all unused sick leave time allowances in excess of 1,040 hours are payable to the employee at the employee's rate of pay at the time of termination. An employee who uses less than 16 hours of sick leave in any benefit year receives up to three days of personal leave in the next year. Personal leave may be used in place of vacation leave, but will not accumulate and will not be paid out at termination. The balance of full time civilian employees are covered by a sick plan that was closed to employees in 1985. That plan accumulates a cash value for every sick day not used, which is payable upon resignation or retirement.

The City also has adopted policies of compensatory time to comply with the Fair Labor Standards Act as amended in 1985. These policies provide limits to the accumulation of compensatory time and also provide that time not used will be paid in cash. Only classified employees and civilian employees in certain pay grades routinely earn compensatory time.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

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

**Bond Premiums, Discounts and Issuance Costs**

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

**Statements of Cash Flows—Cash and Cash Equivalents**

The Fund makes most of its deposits and withdrawals from the City's General Investment Pool, a cash management pool that has the general characteristics of a demand deposit account, in that the Fund may deposit additional cash at any time and may also effectively withdraw cash at any time without prior notice or penalty. The Fund defines cash and cash equivalents as its total equity in the pool. Investments are being held outside of the pool in separate accounts.

**Statements of Net Assets – contracts and retainages payable**

The portion of the contracts and retainages payable that is attributable to the acquisition, construction, or improvement of capital assets is allocated and applied to net assets invested in capital assets, net of related debt.

**3. Deposits and Investments****Cash and Cash Equivalents**

The Fund does not separately account for most deposits and investments, but participates in a City-wide investment pool managed internally by City personnel. The General Investment Pool has the characteristics of a demand deposit, where deposits and withdrawals can be made without notice or penalty. The Fund's total equity in the City's General Investment Pool was \$1,028,270,364 and \$1,018,835,130 at June 30, 2011 and June 30, 2010, respectively.

**Deposits**

The carrying amount of the City's deposit was \$14,058,959 on June 30, 2011 and \$3,140,581 on June 30, 2010. The City's bank balance is the sum of three accounts which total \$53,059,068 on June 30, 2011 and \$ 36,858,133 on June 30, 2010. The three accounts that comprise this balance are described by the following:

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NOTES TO THE FINANCIAL STATEMENTS

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3. Deposits and Investments, continued:

Accounts:	June 30, 2011		June 30, 2010	
	Ledger	Collected	Ledger	Collected
Concentration	\$ 27,950,431	\$ 17,720,094	\$ 20,572,225	\$ 15,000,100
Section 108	9,637,809	9,637,809	293,012	293,012
JPM Money Market Account	15,470,828	15,470,828	15,992,896	15,992,896
Total	\$ 53,059,068	\$ 42,828,731	\$ 36,858,133	\$ 31,286,008
Market Value Collateral	\$ -	\$ -	\$ -	\$ 30,597,021

The first account is a demand deposit account with JP Morgan Chase bank (Chase) that as of June 30, 2011 had a ledger balance of \$ 27,950,431 and a collected balance of \$ 17,720,094. The difference between the ledger and collected balance of \$ 10,230,337 represents checks deposited in this bank account but uncollected by the bank. As of June 2010, JPMorgan Chase Bank had a ledger balance of \$20,572,225 and a collected balance of \$15,000,100. The difference between the ledger and collected balance of \$5,572,125 represents checks deposited in this bank account for which the collection of available funds had not been obtained as of June 30, 2010. The City has a Depository Pledge Agreement whereby Chase pledges collateral to the City to cover balances. As of June 30, 2010, the collateral had a market value of \$30,597,021. According to terms of the Agreement the City is granted a security interest in the pledged securities.

The second account is a demand deposit account with Chase for the City's Housing and Urban Development Section 108 account, which at June 30, 2011 had a collected and ledger balance as of \$9,637,809. As of June 30, 2010 this balance was collateralized by the Depository Pledge Agreement described above. As of June 30, 2011 the collateral requirement for this account the Concentration account was replaced by unlimited FDIC insurance per the Dodd Frank Act. As a result, neither account is currently collateralized.

The third account is an AAA-rated, money market fund that prepares periodic filings with the Securities and Exchange Commission (SEC). The balance in the money market fund as of June 30, 2011 was \$15,470,828. The balance in the money market fund as of June 30, 2010 was \$15,992,896. As this is not a bank account, collateral is not required to be held to cover the balance. There is no custodial risk associated with this money market fund.

**Investments and Risk Disclosures**

The following describes the investment positions of the City's operating funds as of June 30, 2011 and June 30, 2010. On both dates the City had \$2.4 billion, in high grade, fixed income investments in three separate investment pools, each serving a specific purpose as described below. All investments are governed by state law and the City's Investment Policy, which dictates the following objectives, in order of priority:

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

## NOTES TO THE FINANCIAL STATEMENTS

3. Deposits and Investments, continued:

These funds are managed internally by City personnel within a City-wide investment pool in order to gain operational efficiency. This pool consists of all working capital, construction, and debt service funds which are not subject to yield restriction under IRS arbitrage regulations. The funds of the City's enterprise systems, as well as the general fund, are commingled in this pool in order to gain operational efficiency. Approximately 99% of the City's total investable funds are contained in this portfolio for June 30, 2011 and with approximately 99% of investable funds in the portfolio on June 30, 2010.

Pooled Investment as of June 30, 2011	(1)(2) FY2011 & FY2010 Credit Quality Ratings	June 30, 2011		June 30, 2010	
		Market Value	Weighted Average Maturity*	Market Value	Weighted Average Maturity*
U.S. Treasury Notes	n/a	\$ 353,615,147	0.682	\$ 328,615,282	0.746
Housing and Urban Development Notes	n/a	57,467,850	0.796	49,582,022	1.632
Agency Notes (3)	AAA	1,420,454,240	1.316	1,117,992,645	1.831
Agency Notes (3) (4)	not rated	80,096,787	0.038	270,585,010	0.261
Collateralized Mortgage Obligations (3) (4)	not rated	830,394	0.242	4,036,162	0.642
Mortgaged Backed Securities (3) (4)	not rated	159,387,770	2.992	222,477,858	2.654
Money Market Fund	AAA Short Term	200,514,233	0.010	61,240,590	0.110
Certificate of Deposit	FDIC Insured	995,251	0.211	1,972,665	0.284
Commercial Paper Notes	A-1+Short Term	59,938,200	0.183	169,166,494	0.079
Municipal Bonds	AAA Long Term	18,242,881	0.164	48,142,650	1.563
Municipal Bonds	A-1+P-1 Short Term	-	0.000	7,037,271	0.280
Municipal Bonds	AA Long Term	74,138,950	1.232	60,314,781	1.856
Municipal Bonds	A Long Term	6,543,582	0.049	477,477	0.637
<b>Total Investments</b>		<b>\$ 2,432,225,285</b>	<b>1.161</b>	<b>\$ 2,341,640,907</b>	<b>1.385</b>

\* Weighted Average Maturity (WAM) is computed using average life of mortgage backed securities and effective maturity of callable securities.

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

(2) All credit ratings shown are either actual Standard and Poor's (S&P) ratings, or if an S&P credit rating is not available, the equivalent credit rating of Moody's or Fitch.

(3) At June 30, 2011 and June 30, 2010 these are securities issued by government sponsored enterprises, including the Federal Home Loan Bank, Freddie Mac, Fannie Mae and the Federal Agricultural Corporation (Farmer Mac).

(4) These securities were issued by the Federal Home Loan Bank, Freddie Mac, and Fannie Mae. While these individual issues were not rated, senior lien debt of these entities is rated AAA.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

*Interest Rate Risk.* In order to ensure the ability of the City to meet obligations and to minimize potential fair value losses arising from rising interest rate environments, the City's investment policy limits this investment portfolio's dollar weighted average maturity to 2.5 years maximum. As of June 30, 2011, this investment portfolio's dollar-weighted average maturity was 1.189 years. Modified duration was 1.144 years. Modified duration can be used as a multiplier to determine the percent change in price of a bond portfolio for every 100 basis point (1%) change in yield. For example, a portfolio with a modified duration of 1.25 years would experience approximately a 1.25% change in market price for every 100 basis point change in yield.

*Credit Risk - Investments.* The US Treasury Notes and Housing and Urban Development Notes are direct obligations of the United States government. The Agency Notes, Collateralized Mortgage Obligations, and Mortgage Backed Securities were issued by government sponsored enterprises but are not direct obligations of the U.S. Government. The money market mutual funds were rated AAA. Long term municipal securities were rated at least A. Municipal securities considered short-term securities had the highest short-term rating of A-1+.

*Credit Risk - Securities Lending.* Under the securities lending program, the City receives 102% of market value for its U.S. Treasury securities at the time the repurchase agreements are signed, and agreements are limited to 90 days by policy and have been less than 35 days by practice. At June 30, 2011 there were no securities lending agreements outstanding.

*Custodial Credit Risk.* The custodial credit risk for investments is the risk that in the event of the failure of a counterparty, the City will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the City, and are held by either the counterparty or the counterparty's trust department or agent but not in the City's name. As of June 30, 2011, none of the City's investments in the General Investment Pool were subject to custodial credit risk.

*Foreign Currency Risk.* Foreign currency risk is the risk that investments will change value due to changes in exchanges rates between time of purchase and reporting or sale. The City's general pool investments are limited by policy to US dollar denominated investments and not subject to this risk.

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NOTES TO THE FINANCIAL STATEMENTS

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3. Deposits and Investments, continued:**Miscellaneous Money Market Accounts**

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

Investments	FY2011 Credit Quality Ratings	Market Value June 30, 2011	FY2010 Credit Quality Ratings	Market Value June 30, 2010	FY2011 & FY2010 Weighted Average Maturity
JP Morgan US Government Money Market Fund: Airport System Special Facilities Revenue Bonds Series 1997A Reserve Fund.	AA+	\$6,588,848	AAA	\$6,590,824	< 90 days
JP Morgan US Treasury Securities Money Market Fund: Balances held for auction bonds debt service.	AA+	84,585	AAA	212,502	< 90 days
First American US Treasury Money Market Fund: Balance held for commercial paper debt service	AA+	4,230	AAA	2,269	< 90 days
<b>Total Investment</b>		<b><u>\$6,677,663</u></b>		<b><u>\$6,805,595</u></b>	

**Risk Disclosures:**

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

*Credit Risk.* These funds hold only US dollar denominated securities that present minimal credit risk.

*Custodial Credit Risk.* As of June 30, 2011, none of the City's investments in this pool were subject to custodial credit risk.

*Foreign Currency Risk.* The City's investments in this pool are all US dollar denominated and not subject to foreign currency risk.



## NOTES TO THE FINANCIAL STATEMENTS

4. Capital Assets

Summaries of changes in fixed assets for the years ended June 30, 2011 and June 30, 2010 follow (in thousands):

	<b>Balance June 30, 2010</b>	<b>Additions</b>	<b>Retirements</b>	<b>Transfers</b>	<b>Balance June 30, 2011</b>
Capital assets not being depreciated :					
Land	\$209,738	-	(\$143)	\$496	\$210,091
Rights & Intangibles - Non-Depreciable	-	-	-	7,016	7,016
Construction work in progress	470,551	111,208	-	(268,481)	313,278
Total capital assets not being depreciated	<u>680,289</u>	<u>111,208</u>	<u>(143)</u>	<u>(260,969)</u>	<u>530,385</u>
Other capital assets:					
Buildings and building improvements	2,006,729	22	(2,041)	190,808	2,195,518
Improvements other than buildings	1,834,385	-	(997)	47,491	1,880,879
Equipment	157,710	2,844	(4,502)	22,985	179,037
Rights & Intangibles - Amortizable	-	663	-	-	663
Total other capital asset	<u>3,998,824</u>	<u>3,529</u>	<u>(7,540)</u>	<u>261,284</u>	<u>4,256,097</u>
Less accumulated depreciation for:					
Buildings and building improvements	(644,227)	(78,855)	2,042	(1,606)	(722,646)
Improvements other than buildings	(868,878)	(64,552)	997	2,414	(930,019)
Equipment	(110,032)	(19,847)	4,383	(895)	(126,391)
Rights & Intangibles	-	200	-	(228)	(28)
Total accumulated depreciation	<u>(1,623,137)</u>	<u>(163,054)</u>	<u>7,422</u>	<u>(315)</u>	<u>(1,779,084)</u>
Other capital assets, net	<u>2,375,687</u>	<u>(159,525)</u>	<u>(118)</u>	<u>260,969</u>	<u>2,477,013</u>
Total Capital assets, net	<u>\$3,055,976</u>	<u>(\$48,317)</u>	<u>(\$261)</u>	<u>-</u>	<u>\$3,007,398</u>

	<b>Balance June 30, 2009</b>	<b>Additions</b>	<b>Retirements</b>	<b>Transfers</b>	<b>Balance June 30, 2010</b>
Capital assets not being depreciated :					
Land	\$209,311	-	(\$1,400)	\$1,827	\$209,738
Construction work in progress	285,996	257,912	-	(73,357)	470,551
Total capital assets not being depreciated	<u>495,307</u>	<u>257,912</u>	<u>(1,400)</u>	<u>(71,530)</u>	<u>680,289</u>
Other capital assets:					
Buildings and building improvements	1,975,730	455	-	30,544	2,006,729
Improvements other than buildings	1,798,359	6	(290)	36,310	1,834,385
Equipment	151,962	4,660	(3,588)	4,676	157,710
Total other capital asset	<u>3,926,051</u>	<u>5,121</u>	<u>(3,878)</u>	<u>71,530</u>	<u>3,998,824</u>
Less accumulated depreciation for:					
Buildings and building improvements	(564,383)	(79,797)	-	(47)	(644,227)
Improvements other than buildings	(798,180)	(70,893)	148	47	(868,878)
Equipment	(100,072)	(13,496)	3,536	-	(110,032)
Total accumulated depreciation	<u>(1,462,635)</u>	<u>(164,186)</u>	<u>3,684</u>	<u>-</u>	<u>(1,623,137)</u>
Other capital assets, net	<u>2,463,416</u>	<u>(159,065)</u>	<u>(194)</u>	<u>71,530</u>	<u>2,375,687</u>
Total Capital assets, net	<u>\$2,958,723</u>	<u>\$98,847</u>	<u>(\$1,594)</u>	<u>-</u>	<u>\$3,055,976</u>

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**NOTES TO THE FINANCIAL STATEMENTS**


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**5. Leases**

The Airport System is the lessor of approximately 10 percent of its land and substantially all of its buildings and improvements. These lease agreements are non-cancelable operating leases with fixed minimum rentals and non-cancelable operating use and lease agreements with annually adjusted rates. Rental income is earned from leasing various parcels of land with asset costs of \$21,009,107 to airlines, fixed base operators and various corporations for hangars, aircraft maintenance facilities, flight kitchens and cargo buildings; to auto rental companies for their service facilities and storage lots; and to a variety of other entities for buildings and other permanent improvements. Airlines and airport concessionaires lease various sections of City owned airport buildings and improvements for ticket counters, passenger hold rooms, baggage carousels, restaurants, retail stores and other facilities. Leased buildings, improvements and equipment have asset costs of \$4,255,434,476 and carrying costs of \$2,476,378,422. Accumulated depreciation on all these assets is \$1,779,056,054.

Minimum guaranteed income on such non-cancelable operating leases is as follows (in thousands):

<b>Year Ending June 30</b>	<b>Minimum Rental Income</b>
2012	\$ 44,133
2013	35,824
2014	32,801
2015	31,408
2016	27,396
2017-2021	130,937
2022-2026	116,542
2027-2031	48,197
2032-2036	18,216
2037-2041	15,184
2042-2046	6,159
2047-2051	2,758
<b>TOTAL</b>	<b>\$ 509,555</b>

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**NOTES TO THE FINANCIAL STATEMENTS**


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**5. Leases, continued:**

Contingent income associated with these non-cancelable operating leases was approximately \$12,513,470 and \$7,158,963 for the years ended June 30, 2011 and 2010, respectively. Contingent income is earned when a concessionaire's payment, based on a percentage of sales, is higher than the minimum amount guaranteed to the Airport System under the terms of the lease. In addition, income is earned from certain non-cancelable operating use and lease agreements for landing fees and terminal building rentals. Such income is adjusted annually based on a compensatory formula to recover certain operating and capital costs of the related facilities. Compensatory income for the years ended June 30, 2011 and 2010 is as follows (in thousands):

	<b>Compensatory Income</b>	
	<b>2011</b>	<b>2010</b>
Landing Fees	\$ 87,413	\$ 91,443
Terminal Space – Airline	\$ 159,797	\$ 161,096
	<u>\$ 247,210</u>	<u>\$ 252,539</u>

## NOTES TO THE FINANCIAL STATEMENTS

6. Long-Term Liabilities

Changes in long-term liabilities for the years ended June 30, 2011 and 2010 are summarized as follows (in thousands):

	Balance June 30, 2010	Additions	Retirements/ Transfers	Balance June 30, 2011	Amounts Due within One Year
Revenue bonds payable	\$ 2,487,425	\$ 93,730	\$ (140,135)	\$ 2,441,020	\$ 52,285
Plus unamortized premium	12,319	-	(736)	11,583	-
Less unamortized discount	(28,393)	-	1,186	(27,207)	-
Less deferred amount on refundings	(14,838)	(2,832)	2,323	(15,347)	-
Revenue bonds payable, net	<u>2,456,513</u>	<u>90,898</u>	<u>(137,362)</u>	<u>2,410,049</u>	<u>52,285</u>
Inferior lien contract	41,735	-	(4,305)	37,430	4,535
Inferior lien contract, net	<u>41,735</u>	<u>-</u>	<u>(4,305)</u>	<u>37,430</u>	<u>4,535</u>
Commercial paper payable	6,000	-	(6,000)	-	-
Pension obligation bonds	2,006	-	-	2,006	-
Compensated absences	10,830	9,374	(8,183)	12,021	4,865
Claims for workers compensation	3,338	86	(797)	2,627	797
Net pension obligation payable	37,205	4,878	-	42,083	-
Other post employment benefits	29,997	8,278	-	38,275	-
Other long-term liabilities	-	331	-	331	-
Total long-term liabilities	<u>\$ 2,587,624</u>	<u>\$ 113,845</u>	<u>\$ (156,647)</u>	<u>\$ 2,544,822</u>	<u>\$ 62,482</u>

	Balance June 30, 2009	Additions	Retirements/ Transfers	Balance June 30, 2010	Amounts Due within One Year
Revenue bonds payable	\$ 2,083,255	\$ 449,660	\$ (45,490)	\$ 2,487,425	\$ 47,335
Plus unamortized premium	10,853	2,142	(676)	12,319	-
Less unamortized discount	(25,890)	(3,562)	1,059	(28,393)	-
Less deferred amount on refundings	(15,798)	-	960	(14,838)	-
Revenue bonds payable, net	<u>2,052,420</u>	<u>448,240</u>	<u>(44,147)</u>	<u>2,456,513</u>	<u>47,335</u>
Inferior lien contract	45,820	-	(4,085)	41,735	4,305
Inferior lien contract, net	<u>45,820</u>	<u>-</u>	<u>(4,085)</u>	<u>41,735</u>	<u>4,305</u>
Commercial paper payable	93,000	-	(87,000)	6,000	6,000
Pension obligation bonds	2,006	-	-	2,006	-
Compensated absences	10,003	8,025	(7,198)	10,830	5,113
Claims for workers compensation	4,435	(187)	(910)	3,338	910
Net pension obligation payable	33,329	3,876	-	37,205	-
Other post employment benefits	20,648	9,349	-	29,997	-
Total long-term liabilities	<u>\$ 2,261,661</u>	<u>\$ 469,303</u>	<u>\$ (143,340)</u>	<u>\$ 2,587,624</u>	<u>\$ 63,663</u>

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NOTES TO THE FINANCIAL STATEMENTS

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6. Long-Term Liabilities, continued:**Purpose of Debt**

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

**Debt Service Requirements to Maturity**

These schedules have been updated to include the effects of the Airport Subordinate Lien Refunding, Bonds, Series 2011A and 2011B, issued July 21, 2011. These bonds are described in the Subsequent Events section of these Footnotes.

Aggregate future Airport system debt service payments to maturity as of June 30, 2011 were as follows (in thousands):

Year Ending June 30	Airport System Total Future Requirements		
	Principal	Interest	Total
2012	\$ 56,820	\$ 105,622	\$ 162,442
2013	57,585	103,130	160,715
2014	62,835	100,885	163,720
2015	63,185	98,229	161,414
2016	74,390	95,227	169,617
2017-2021	414,795	422,532	837,327
2022-2026	544,130	319,958	864,088
2027-2031	680,520	196,718	877,238
2032-2036	387,746	61,578	449,324
2037-2041	116,005	13,187	129,192
Total	\$ 2,458,011	\$ 1,517,066	\$ 3,975,077

Year Ending June 30	Airport System Pension Obligations	
	Principal	Interest
2012	\$ -	\$ 107
2013	-	106
2014	-	106
2015	-	106
2016	-	106
2017-2021	-	533
2022-2026	-	533
2027-2031	925	485
2032-2036	1,081	137
2037-2041	-	-
Total	\$ 2,006	\$ 2,219

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NOTES TO THE FINANCIAL STATEMENTS

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6. Long-Term Liabilities, continued:

Year Ending June 30	Airport System Subordinate Lien Revenue Bonds	
	Principal	Interest
2012	\$ 52,285	\$ 79,771
2013	52,805	77,530
2014	57,795	75,552
2015	57,870	73,181
2016	59,510	70,711
2017-2021	348,830	311,010
2022-2026	475,445	224,352
2027-2031	591,785	120,863
2032-2036	272,590	13,184
2037-2041	-	-
Total	<u>\$ 1,968,915</u>	<u>\$ 1,046,154</u>

Year Ending June 30	Airport System Senior Lien Revenue Bonds	
	Principal	Interest
2012	\$ -	\$ 23,819
2013	-	23,819
2014	-	23,819
2015	-	23,819
2016	9,275	23,587
2017-2021	53,810	110,312
2022-2026	68,685	95,073
2027-2031	87,810	75,370
2032-2036	114,075	48,257
2037-2041	116,005	13,187
Total	<u>\$ 449,660</u>	<u>\$ 461,062</u>

Year Ending June 30	Airport System Inferior Lien Contract	
	Principal	Interest
2012	\$ 4,535	\$ 1,925
2013	4,780	1,675
2014	5,040	1,408
2015	5,315	1,123
2016	5,605	823
2017-2021	12,155	677
2022-2026	-	-
2027-2031	-	-
2032-2036	-	-
2037-2041	-	-
Total	<u>\$ 37,430</u>	<u>\$ 7,631</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

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

On December 21, 2010, the City issued \$93,730,000 of Airport System Subordinate Lien Revenue Refunding Bonds, Series 2010. Proceeds of the bonds were used to currently refund the Airport System Subordinate Lien Revenue Refunding Bonds, Series 2005A. The Series 2010 bonds mature in varying amounts from 2011 to 2030. The Series 2010 bonds were issued as variable rate demand obligations with an initial weekly interest reset. The initial interest rate was 0.290%. The refunded Series 2005A were also variable rate demand obligations and paid interest at varying rates depending on current market conditions, so cash flow and net present value savings cannot be computed. S&P and Moody's assigned ratings of A and A2, respectively, to the Series 2010 issue. The Series 2010 Bonds are not subject to the alternative minimum tax (AMT) as they are issued under the AMT Holiday provision of the American Recovery and Reinvestment Act. Principal and interest on Series 2010 Bonds tendered and not remarketed will be payable from a direct-pay letter of credit issued by Barclay's Bank PLC. The letter of credit will expire on December 21, 2012, unless extended or terminated.

On August 20, 2009, the City issued \$449,660,000 of Airport System Senior Lien Revenue and Refunding Bonds, Series 2009A at rates ranging from 5.0% to 5.5%. The true interest cost was 5.42%. The bonds mature in varying amounts from 2015 to 2039. Proceeds were set aside to fund \$289.2 million in new construction, to fund a senior lien debt service reserve fund of \$33.1 million, to create a capitalized interest fund, to pay costs of issuance, and to currently refund \$87 million of Senior Lien Commercial Paper Series A. The Airport Bonds were issued to replace the variable rate commercial paper and lock in long term fixed rates, rather than to achieve debt service savings. Cash flow and net present value savings cannot be computed because the refunded commercial paper paid interest at varying rates depending on current market conditions. The Series 2009A Bonds are the first series to be issued at the Senior Lien level. S&P and Moody's assigned ratings of AA- and Aa3, respectively, to the issue. The Series 2009A Bonds are not subject to the alternative minimum tax (AMT) as they are issued under the AMT Holiday provision of the American Recovery and Reinvestment Act.

**Security for Airport Debt**

To the extent it legally may do so, the Fund covenants in its bond ordinances to charge rates for use of the Airport System in order that in each fiscal year the net revenues will be not less than 125% of the debt service requirements for Senior Lien Bonds for such fiscal year and 110% of the debt service requirements for Subordinate Lien Bonds for such fiscal year. Certain bonds have additional requirements for accumulation of principal and interest repayment amounts from surplus operating funds. Generally, the bonds may be redeemed prior to their maturities in accordance with the bond ordinances and at prices which include premiums ranging downward from 5%. During fiscal years 2011 and 2010, the City has complied with the requirements of all financial revenue bond ordinances and related bond restrictions.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

The Fund presently has three outstanding Senior Lien Debt Service Reserve Fund Surety Policies issued by Financial Guaranty Insurance Corporation (FGIC) and reinsured by National Public Finance Guarantee Corporation for any outstanding Senior Lien Notes. These policies have an aggregate maximum amount of \$12,374,996 and terminate on October 25, 2023 and July 1, 2030. There are no outstanding notes at June 30, 2011. Using proceeds of the Series 2009A Bonds, the Fund has also deposited \$33,095,993.76 into the Senior Lien Bond Reserve Fund.

The Fund has purchased Subordinate Lien Debt Service Reserve Fund Surety Policies that unconditionally guarantee the payment of the current principal and interest on all outstanding airport system subordinate lien issues. The reserve policies terminate on dates ranging from July 1, 2017 to July 1, 2032. Each of the draws made against the reserve policies shall bear interest at the prime rate plus two percent, not to exceed a maximum interest rate of 12%. The repayment provisions require one-twelfth of the policy costs for each draw to be repaid monthly, beginning the first month following the date of each draw. The policies were issued by (1) FGIC in the aggregate maximum amount of \$108,444,368.70, reinsured by National Public Finance Guarantee Corporation; (2) Assured Guarantee Municipal Corporation in the aggregate maximum amount of \$31,921,383.50; and (3) Syncora Guarantee in the aggregate maximum amount of \$15,756,228. While the Syncora policies are still active, the Fund has made a supplemental cash deposit of \$15,756,228 in the Subordinate Lien Bond Reserve Fund.

**Airport System Inferior Lien Contract**

On July 1, 2004 the City and Continental Airlines, Inc. entered into a Sublease Agreement associated with the Special Facilities Lease for the Automated People Mover System and the City's Airport System Special Facilities Revenue Bonds (Automated People Mover Project) Series 1997A (1997A Special Facilities Bonds). The City assumed Continental's interest in the project upon completion of the expansion of the Automated People Mover System on January 25, 2005. As part of the Sublease, the City agreed to make sublease payments that include amounts equal to the debt service on the 1997A Special Facilities Bonds. The payments are payable from Airport system net revenues on the same priority as inferior lien bonds. Accordingly, the principal amount remaining on the 1997A Special Facilities Bonds, totaling \$37,430,000 at June 30, 2011, is recorded as an Inferior Lien Contract.



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**NOTES TO THE FINANCIAL STATEMENTS**

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**6. Long-Term Liabilities, continued:****Variable Rate Debt**

The Fund has issued variable rate debt in Airport System Subordinate Lien Revenue Bonds Series 2000P-1 and Series 2000P-2. They were issued as auction reset securities with Series 2000P-1 to be auctioned every 7 days, and Series P-2 to be auctioned every 28 days. On July 20, 2005, Series P-2 changed to being auctioned every 7 days. Rates in effect at June 30, 2011, including dealer and auction fees, were 0.3975% and 0.3975%, respectively. Additional variable rate debt was issued as Series 2002C, Series 2002D-1, and Series 2002D-2 as auction rate securities to be auctioned every 35 days. These changed to being auctioned every 7 days as of August 10, 2005, August 3, 2005, and July 13, 2005, respectively. Rates in effect at June 30, 2011, including dealer and auction fees, were 0.626%, 0.626%, and 0.626%, respectively. Starting in February 2008, various auction rate securities began, and continue, to not be remarketed. Auction rate bonds that cannot be sold remain with the bondholder.

However, if the auction is not successful, the rate is reset based on predetermined formulae which include the rating of the insurer, or the underlying rating of the Fund if it is higher than the insurer's rating. The formula for the Series 2000P-1 and Series 2000P-2 was 125% of the commercial paper rate until July 30, 2009 150% until April 16, 2010 and 200% thereafter. The formula for the Series 2002C, Series 2002D-1, and Series 2002D-2 is 200% of LIBOR.

Additional variable rate debt was issued as Series 2005A as variable rate demand obligations with a weekly reset. Series 2005A was refunded by Series 2010 on December 21, 2010. Series 2010 is also a variable rate demand obligations issue with a weekly reset. The rate in effect at June 30, 2011, including remarketing fees, was 0.120%. Should Series 2010 bonds be tendered and not remarketed, principal and interest will be paid by a letter of credit issued by Barclay's Bank PLC. The letter of credit will expire on December 21, 2012, unless extended or terminated. Because the Series 2010 Bonds were issued as multi-modal bonds, the Houston Airport System can elect to convert the Bonds into long-term fixed rate bonds that would not require a letter of credit.

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NOTES TO THE FINANCIAL STATEMENTS

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6. Long-Term Liabilities, continued:

Revenue bonds payable for the years ended June 30, 2011 and 2010 (in thousands):

	Stated Interest Rate Range	Face Value Outstanding June 30, 2011	Face Value Outstanding June 30, 2010
Airport System Subordinate Lien Revenue Refunding Bonds, Series 1997, \$33,255,000 original principal, matures in 2017	4.5%-5.125%	\$ 220	\$ 430
Airport System Subordinate Lien Revenue Refunding Bonds, Series 1998A, \$70,405,000 original principal, matures in 2017	5.25%-6%	35,310	39,265
Airport System Subordinate Lien Revenue Bonds, Series 1998B, \$479,940,000 original principal, matures in 2028	3.9%-5.25%	369,265	385,550
Airport System Subordinate Lien Revenue Bonds, Series 1998C, \$150,905,000 original principal, matures in 2028	3.8%-5%	144,090	145,065
Airport System Subordinate Lien Revenue Bonds, Series 2000A, \$327,225,000 original principal, matures in 2030	5%-6%	199,005	206,160
Airport System Subordinate Lien Revenue Bonds, Series 2000B, \$269,240,000 original principal, matures in 2030	5.45%-5.7%	44,515	44,515
Airport System Subordinate Lien Revenue Bonds, Series 2000P-1, \$50,000,000 original principal, (Periodic Auction Reset Securities), matures in 2030	N/A	44,175	44,175
Airport System Subordinate Lien Revenue Bonds, Series 2000P-2, \$50,000,000 original principal, (Periodic Auction Reset Securities), matures in 2030	N/A	42,725	43,950
Airport System Subordinate Lien Revenue Refunding Bonds, Series 2001A, \$65,475,000 original principal, matures in 2021	4%-5.5%	37,505	41,340

## NOTES TO THE FINANCIAL STATEMENTS

6. Long-Term Liabilities, continued:

Revenue bonds payable for the years ended June 30, 2011 and 2010 (in thousands): (continued)

	Stated Interest Rate Range	Face Value Outstanding June 30, 2011	Face Value Outstanding June 30, 2010
Airport System Subordinate Lien Revenue Bonds, Series 2002A, \$200,050,000 original principal, matures in 2032	5%-5.625%	200,050	200,050
Airport System Subordinate Lien Revenue Bonds, Series 2002B, \$274,455,000 original principal, matures in 2032	5%-5.5%	257,360	263,350
Airport System Subordinate Lien Revenue Bonds, Series 2002C, \$100,000,000 original principal, (Auction Rate Securities), matures in 2032	N/A	90,925	94,925
Airport System Subordinate Lien Revenue Bonds, Series 2002D-1, \$75,000,000 original principal, (Auction Rate Securities), matures in 2032	N/A	69,850	69,850
Airport System Subordinate Lien Revenue Bonds, Series 2002D-2, \$75,000,000 original principal, (Auction Rate Securities), matures in 2032	N/A	67,875	69,875
Airport System Subordinate Lien Revenue Refunding Bonds, Series 2005A, \$92,900,000 original principal, (Variable Rate Debt Obligations), matures in 2030	N/A	-	92,900
Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007B, \$298,670,000 original principal, matures in 2032	4%-5%	294,760	296,365
Airport System Senior Lien Revenue and Refunding Bonds, Series 2009A, \$449,660,000 original principal, matures in 2039	5%-5.5%	449,660	449,660
Airport System Subordinate Lien Revenue Refunding Bonds, Series 2010, \$93,730,000 original principal, (Variable Rate Debt Obligations), matures in 2030	N/A	93,730	-
Total principal		2,441,020	2,487,425
Less: Total current maturities		(52,285)	(47,335)
Unamortized discount		(27,207)	(28,393)
Unamortized premium		11,583	12,319
Deferred amount on refunding		(15,347)	(14,838)
Total revenue bonds payable - long term		<u>\$ 2,357,764</u>	<u>\$ 2,409,178</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

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

Arbitrage rebate rules, under Chapter 148 of the Federal Tax Code, require generally that a tax-exempt bond issuer pay to the federal government any profit made from investing bond proceeds at a yield above the bond yield, when investing in a taxable market. Payments based on cumulative profit are due, in general, every five years. There was no arbitrage rebate payable by the Airport Fund for fiscal year ended June 30, 2010. At June 30, 2011, yield restriction payable by the Airport Fund is \$447.

**Commercial Paper**

Airport System Commercial Paper Notes (the Notes) have been authorized for \$150 million for Series A and B and \$150 million for Series C to establish, improve, enlarge, and extend the Houston Airport System, acquire land, and pay interest on the Notes. At June 30, 2009, \$87.0 million was outstanding in Series A and \$6.0 million was outstanding in Series B. Series A was refunded by the Airport Senior Lien Revenue and Refunding Bonds, Series 2009A, dated August 20, 2009. Series B was paid from existing cash on July 23, 2010. There are no outstanding Notes on June 30, 2011.

Series A and B are collateralized by a direct pay letter of credit issued by Bank of America, N.A. on December 22, 2010, replacing a letter of credit issued by Dexia Credit Local. The letter of credit covers \$150 million face value plus \$11,095,891 in respect of 270 days accrued interest computed at 10%. It will terminate on December 20, 2013.

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

**Pledged Revenues**

The Fund has pledged airport system revenues, net of operation and maintenance expenses, to pay principal and interest on outstanding Senior Lien Commercial Paper Notes, Senior Lien Revenue Bonds, Subordinate Lien Revenue Bonds, and an Inferior Lien Contract, with outstanding principal amounts of \$0, \$449,660,000, \$1,991,360,000 and \$37,430,000, respectively at June 30, 2011. The Commercial Paper Notes and Revenue Bonds are issued to establish, improve, enlarge, extend and repair the Airport System. The Inferior Lien Sublease Agreement with Continental Airlines pays debt service on the Airport System Special Facilities Bonds, (Automated People Mover Project) Series 1997A.

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**NOTES TO THE FINANCIAL STATEMENTS**

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

Pledged airport system revenues exclude: proceeds of any bonds, replacement proceeds, or any investment income earned by bond proceeds; passenger facility charges; grants or gifts for construction or acquisition; insurance proceeds; revenue from special facilities pledged to Special Facility Bonds; taxes collected for others; and proceeds from the sale of property. Pledged airport system revenues, net of operation and maintenance expense, totaled \$160,964,000 in Fiscal Year 2011, covering principal of \$61,136,000 and interest of \$97,705,000. In addition to pledged airport system revenue, grants and passenger facility charges totaling \$56,827,000 were available to cover debt service in Fiscal Year 2011, making the ratio of net pledged revenue to cover reduced debt service costs 1.58%.

**7. Defined Benefit Pension Plan**

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

**Plan Description**

The Municipal Employees Pension System of the City is a single employer defined benefit pension plan that covers all eligible municipal employees, including all employees of the Fund. This pension plan was established under the authority of Texas statutes (Vernon's Texas Civil Statutes, Articles 6243g), which establish the various benefit provisions. The plan provides for service-connected disability and death benefits to survivors, with no age or service eligibility requirements. Employer and employee obligations to contribute, as well as employee contribution rates, are included in the statutes. Some requirements are delineated in the meet and confer agreements of September 2004. Additionally, these laws provide that employer funding be based on periodic actuarial valuations, statutorily approved amounts or amounts agreed to in meet and confer agreements. The plan provides service, disability, death, and vesting benefits. The plan recognizes participant and employer contributions as revenues in the period in which they are due pursuant to formal commitments and recognizes benefits and refunds when they are due and payable in accordance with the terms of the pension statutes.

On November 10, 2004 the City issued a \$300,000,000 collateralized note (The Collateralized Note) to the Houston Municipal Employees Pension System (HMEPS) as part of the meet and confer agreement with the HMEPS to fund part of the unfunded accrued actuarial liability of its pension plan. The notes bore interest at 8.5% per year. The promissory note from the Houston Hotel Corporation to the City, as well as the related Deed of trust, had been pledged as collateral on the notes. Interest on the notes could be paid or deferred, at the City's option, up to a maximum of \$150,000,000 plus 75% of the amount by which the appraisal value of the hotel exceeded \$300,000,000. If the interest is deferred, the City could issue uncollateralized deferred interest certificates that could be converted to assignable certificates at the request of the HMEPS up to \$150 million, or collateralized deferred interest certificates up to the limit based on the appraisal value of the hotel.

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NOTES TO THE FINANCIAL STATEMENTS

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7. Defined Benefit Pension Plan, continued:**Airport System Fund Liability**

The Airport System Fund's liability for the net pension obligation in the City's pension plan was allocated and reported on the statement of net assets.

The City issued Taxable General Obligation Pension Bonds on March 30, 2005. Although these bonds have an ad valorem tax pledge, the responsibility for \$2,005,656 of these bonds has been allocated to the Airport System Fund.

**Actuarially Determined Contribution Requirements and Contributions Made**

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

The reported contributions to the pension funds for the year ended June 30, 2011, were different from the actuarially determined requirements based on the July 1, 2010 actuarial valuations.

**Contributions are as follows:**

	<b>2011</b>	<b>2010</b>
	<b>Percentage of Payroll</b>	<b>Percentage of Payroll</b>
City of Houston normal cost	5.9%	5.8%
Amortization of unfunded actuarial accrued liability	<u>16.5%</u>	<u>14.3%</u>
Required employer contribution rate	<u>22.4%</u>	<u>20.1%</u>
Employer contribution made	<u>15.8%</u>	<u>14.9%</u>
Employee contribution made	<u>5.0%</u>	<u>5.0%</u>
	<b>2011</b>	<b>2010</b>
	<b>Contribution Amounts</b>	<b>Contribution Amounts</b>
	<b>(in thousands)</b>	<b>(in thousands)</b>
Net contribution required	<u>\$132,012</u>	<u>\$132,422</u>
Total City contribution	\$88,500	\$83,500
Total employee contribution	<u>\$19,326</u>	<u>\$19,736</u>
Total contribution	<u>\$107,826</u>	<u>\$103,236</u>

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**NOTES TO THE FINANCIAL STATEMENTS**


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**7. Defined Benefit Pension Plan, continued:****Annual Pension Cost and Net Pension Obligation**

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

	<u>June 30, 2011</u>	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Annual required contribution	\$ 125,148	\$ 112,714	\$ 101,952
Interest on net pension obligation	29,480	26,610	24,264
Adjustment to annual required contribution	(24,791)	(22,062)	(20,117)
Annual pension cost	<u>129,837</u>	<u>117,262</u>	<u>106,099</u>
Contribution Made	88,500	83,500	78,500
Change in net pension obligation	(41,337)	(33,762)	(27,599)
Net pension obligation beginning	<u>(346,824)</u>	<u>(313,062)</u>	<u>(285,463)</u>
Net pension obligation end of year	<u>\$ (388,161)</u>	<u>\$ (346,824)</u>	<u>\$ (313,062)</u>

**Schedule of Employer Contributions (in millions)**

<u>Year Ended June 30</u>	<u>Annual Pension Cost</u>	<u>Percentage Contributed</u>	<u>Net Pension Obligation</u>	<u>Annual Required Contribution As a % Of Base Pay</u>
2009	\$106.1	74.0%	\$313.1	19.2%
2010	\$117.2	71.2%	\$346.8	20.1%
2011	\$129.8	68.2%	\$388.2	22.4%

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**NOTES TO THE FINANCIAL STATEMENTS**


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

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

Valuation Date	July 01, 2010
Actuarial cost method	Entry Age Normal cost
Amortization method	Level percentage of payroll over an open period of 30 years
Remaining amortization period	29 years
Asset valuation method	5 year smoothed market
Actuarial assumptions:	
Investment rate of return	8.5%, net of expenses
Payroll growth factor	3.0%
Projected individual salary increases	Graded rates based on years of service
General inflation rate	3.0%

**Schedule of Funding Progress (in millions)**

Actuarial Valuation Date	Actuarial Value of Plan Asset ( a )	Actuarial Accrued Liability (AAL) Entry Age ( b )	Unfunded AAL (Surplus UAAL) ( b-a )	Funded Ratio ( a/b )	Projected Annual Covered Payroll ( c )	UAAL as Percentage Of covered Payroll (( b-a )/c )
July 01, 2008	\$2,310.4	\$3,296.4	\$986.0	70%	\$483.8	204%
July 01, 2009	\$2,284.4	\$3,451.4	\$1,167.0	66%	\$539.0	217%
July 01, 2010	\$2,273.1	\$3,632.5	\$1,359.4	63%	\$550.7	247%

**8. Other Employee Benefits****Post-Retirement Health Insurance Benefits**

Pursuant to a City Ordinance, the City provides certain health care benefits for retired employees. Substantially all of the City's employees become eligible for these benefits if they reach normal retirement age while working for the City. Contributions are recognized in the year paid. The cost of retiree health care premiums incurred by the City (employer and subscriber) amounted to approximately \$64,342,456 and \$58,508,171 for the years ended June 30, 2011 and June 30, 2010 respectively. Retiree health care is accounted for in the Health Benefits Fund, an Internal Service Fund. At June 30, 2011, there were 8,227 retirees eligible to receive benefits.



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NOTES TO THE FINANCIAL STATEMENTS

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

Effective August 1, 2011 all Medicare Eligible Retirees must enroll in an insured Medicare Advantage Program Plan.

The City of Houston OPEB plan is a single-employer plan, and calculations are based on the OPEB benefits provided under the terms of the plan in effect at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point.

Actuarial valuations for OPEB plans involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as results are compared to past expectations and new estimates are made into the future.

The schedule of funding progress for the postemployment defined benefit plan immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

**Airport System Fund Liability**

The Airport System Fund's liability for the net OPEB obligation in the City's pension plan was allocated and reported on the statement of net assets.

**Annual Other Post Employment Benefits (OPEB) Cost and Net OPEB (Obligation) Asset**

The annual OPEB cost associated with the City's retiree health care costs for the current year is as follows (in thousands):

	<b>OPEB</b>		
	<u>June 30, 2011</u>	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Annual required contribution	\$ 237,466	\$ 281,358	\$ 274,471
Interest on net OPEB obligation	31,896	22,043	12,145
Adjustment to annual required contribution	(43,514)	(30,073)	(16,569)
Annual OPEB cost	<u>225,848</u>	<u>273,328</u>	<u>270,047</u>
Contribution made	(48,863)	(58,550)	(56,285)
Change in net OPEB Obligation	176,985	214,778	213,762
Net OPEB obligation beginning of year	700,581	485,803	272,041
Net OPEB obligation end of year	<u>\$ 877,566</u>	<u>\$ 700,581</u>	<u>\$ 485,803</u>

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NOTES TO THE FINANCIAL STATEMENTS

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8. Other Employee Benefits, continued:

Fiscal Year Ended <u>June 30</u>	Annual OPEB <u>Cost</u>	Percentage of Annual OPEB <u>Cost Contributed</u>	Net OPEB <u>Obligation</u>
2009	\$270,047	20.9%	\$485,803
2010	\$273,328	21.4%	\$700,581
2011	\$225,848	21.6%	\$877,566

## Schedule of Funding Progress (in millions)

Year Ended 30-Jun	Actuarial Value of Assets ( a )	Actuarial Accrued Liability (AAL) ( b )	Unfunded AAL ( b-a )	Funded Ratio	Covered Payroll ( c )	UAAL As a % of Covered Payroll ((b-a)/c)
2009	\$0	\$3,096	\$3,096	0%	\$1,136.5	272%
2010	\$0	\$3,031	\$3,031	0%	\$1,193.5	254%
2011	\$0	\$1,984	\$1,984	0%	\$1,208.9	164%

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as to the actuarial valuation used for purposes of the financial statements is as follows:

Valuation Date	June 30, 2010
Actuarial cost method	Entry age Normal Cost
Amortization method	Level percent of payroll over an open period of 30 years
Discount Rate	4.5%
Annual increase attributable to seniority/ merit	3.0% to 10.0%
Medical trend rates	5.0% to 10.0%

**Health Benefits Internal Service Fund**

Effective May 1, 2011, the City elected to be substantially self-insured and awarded CIGNA a three year contract with two (2) one-year renewal options for 4 new health plans. All have a heavy emphasis on a wellness component, and include: 1) a limited network HMO-type plan, 2) an open access PPO type plan with out-of-network coverage, 3) a consumer driven high deductible health plan, partnered with a health reimbursement account, and, 4) a specific plan for retirees, mostly those under age 65, who live outside the limited network, service area but who live in Texas. To mitigate the city exposure, in place is an Individual Stop Loss Limit of \$500,000 and an Aggregate Stop Loss Corridor Factor of 105% with unlimited maximum aggregate stop loss benefit for the policy period.

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NOTES TO THE FINANCIAL STATEMENTS

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

The previous City's Health Benefits plan administered by HMO Blue Texas expired April 30, 2011, employees and retirees were able to choose between a HMO Plan with all benefits covered by third party purchased insurance or a self insured Preferred Provider Organization Plan (PPO) with specific individual and aggregate stop loss features.

Premiums paid (employer and subscriber) for current employees to third party administrators totaled \$225,127,098 and \$214,394,276 for the year ended June 30, 2011 and June 30, 2010 respectively.

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

	<b>PPO, OOA, AND CIGNA</b>	
	<b>Schedule of Changes in Liability</b>	
	<b>(in thousands)</b>	
	<b><u>June 30, 2011</u></b>	<b><u>June 30, 2010</u></b>
Beginning actuarial estimate of		
Claims liability, July 1	\$ 897	\$ 943
Incurred claims for fiscal year	47,432	9,350
Payments on claims	(31,366)	(9,635)
Actuarial adjustment	-	239
Ending estimate of claims liability, June 30	<b><u>\$ 16,963</u></b>	<b><u>\$ 897</u></b>

The City also provides one times salary of basic life insurance, with a minimum of \$15,000, at no cost to the employee. The employee, at no cost to the City, may then obtain additional life insurance up to four times their annual salary. The current cost for active employees for both basic and voluntary life insurance totaled \$5,750,931 and \$5,471,246 for the year ended June 30, 2011 and June 30, 2010, respectively.

**Long-Term Disability Plan**

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

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NOTES TO THE FINANCIAL STATEMENTS

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8. Other Employee Benefits, continued:

	<b>Schedule of Changes in Liability</b>	
	<b>(in thousands)</b>	
	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Beginning actuarial estimate of claims liability, July 1	\$ 7,869	\$ 8,059
Incurred claims for fiscal year	1,356	2,413
Payments on claims	(801)	(770)
Actuarial adjustment	(574)	(1,833)
Ending actuarial estimate of claims liability, June 30	<u>\$ 7,850</u>	<u>\$ 7,869</u>

**Deferred Compensation Plan**

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

**Workers' Compensation Self-Insurance Plan**

The City has established a Workers' Compensation Self-Insurance Plan, accounted for within the various operating funds. The plan is administered by Cambridge Integrated Services Group, Inc. Funds are wire transferred to Cambridge as needed to pay claims.

At June 30, 2011 the City has an accumulated liability in the amount of \$55 million covering estimates for approved but unpaid claims and incurred but not reported claims (calculated on an actuarial basis) recorded in the Statement of Net Assets and Enterprise Funds. The amount of liability is based on an actuarial study.

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NOTES TO THE FINANCIAL STATEMENTS

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8. Other Employee Benefits, continued:

<b>Schedule of Changes in Liability</b>		
<b>(in thousands)</b>		
	<b>June 30, 2011</b>	<b>June 30, 2010</b>
Beginning actuarial estimate of claims liability, July 1	\$ 67,089	\$ 76,718
Incurred claims for fiscal year	8,077	7,947
Payments on claims	(14,323)	(14,011)
Actuarial adjustment	(5,899)	(3,565)
Ending actuarial estimate of claims liability, June 30	\$ 54,944	\$ 67,089

9. Transactions with City of Houston**Interfund Services**

The City charges the Fund for certain services performed by other City funds on behalf of the Airport System Fund. Such charges were as follows for the years ended June 30, 2011 and 2010 (in thousands):

	<b>2011</b>	<b>2010</b>
Police services	\$ 23,071	\$ 20,195
Fire services	16,861	16,354
Indirect support services	3,142	2,771
Water and sewer services	2,889	3,334
Other	1,393	376
Total	\$ 47,356	\$ 43,030

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

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

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NOTES TO THE FINANCIAL STATEMENTS

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9. Transactions with City of Houston, continued:**Due to and Due from the City of Houston**

Amounts due to and due from other funds of the City at June 30, 2011 and 2010 are as follows (in thousands):

	2011		2010	
	<u>Due to</u>	<u>Due From</u>	<u>Due to</u>	<u>Due From</u>
General Fund	\$ 973	\$ 111	\$ 186	\$ 787
Nonmajor Governmental Funds		.	160	.
Internal Service Fund		329		60
Grants Revenue Fund	235	513	192	9,985
Total	<u>\$ 1,208</u>	<u>\$ 953</u>	<u>\$ 538</u>	<u>\$ 10,832</u>

10. Major Customers

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

	<u>Percentage of Operating Revenue</u>	
	<u>2011</u>	<u>2010</u>
Continental Airlines	34.4%	37.9%
Continental partners	5.8%	6.2%
United Air Lines, Inc.	0.4%	1.0%
United partners	0.1%	0.1%
<b>United Continental Holdings, Inc.*</b>	<b>40.7%</b>	<b>45.2%</b>
AirTran	0.4%	0.4%
Southwest Airlines	7.3%	7.9%
<b>Southwest Airlines &amp; AirTran**</b>	<b>7.7%</b>	<b>8.3%</b>

\*On October 1, 2010 UAL Corporation (the parent company of United Airlines) merged with Continental and changed its name to United Continental Holdings, Inc.

\*\*On May 02, 2011 Southwest Airlines closed on its purchase of all outstanding common stock of AirTran Holdings, Inc., the former parent of AirTran Airways.

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**NOTES TO THE FINANCIAL STATEMENTS**

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**11. Conduit Debt Obligations**

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

At June 30, 2011, the aggregate value of Special Facility Revenue Bonds outstanding was \$608,565,000, which includes \$37,430,000 of the City of Houston Special Facility Revenue Bonds (Automated People Mover System), Series 1997A bonds. The Series 1997A bonds are supported by an inferior lien contract between the Fund and Continental Airlines which is included in the Fund's liabilities. At June 30, 2010, outstanding conduit bonds totaled \$619,045,000.

**12. Commitments and Contingencies****Litigation and Claims**

The City is the defendant in various lawsuits arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. These matters affecting the Airport System are primarily contract and real property disputes. The status of such litigation ranges from early discovery to various levels of appeal, against which the City will continue to vigorously defend itself. Additionally, there are also various personal injury claims filed against the Airport System which will also be vigorously defended. The amount of damages is limited in certain cases under the Texas Torts Claim Act and is subject to appeal. Management has determined the amounts of loss, if any, would not be material in these financial statements.

**Environmental Liabilities**

The Houston Airport System is aware of various sites contaminated by asbestos, mold, and groundwater contamination. The assessment and remediation of asbestos, mold and groundwater contamination are ongoing and included in the costs of the capital project at the time it becomes an obligating event under GASB No. 49. Management has determined that the costs of the remediation would not be material in these financial statements.

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**NOTES TO THE FINANCIAL STATEMENTS**

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**12. Commitments and Contingencies, continued:****Commitments for Capital Facilities**

At June 30, 2011 and 2010, the Fund had contracted for, but not spent, \$106,850,145 and \$169,176,518 respectively, for capital projects.

**Risk Management**

The City purchases fidelity coverage to comply with City ordinance, boiler and machinery insurance with a per occurrence loss limit of \$100 million and commercial property insurance with a per occurrence loss limit of \$150 million. The current sub-limit for flood is \$75 million, of which \$50 million may apply to locations in the 100-year flood plain (Flood Zone A). Property insurance provides deductibles as follows: \$2.5 million per occurrence for all perils except; 3% of the damaged insured value for windstorm or hail from a named storm, subject to a \$2.5 million minimum and a \$20 million maximum deductible; and 5% of the damaged insured value for flood, subject to a \$5 million minimum and a \$20 million maximum deductible. Should a named storm event occur that involves both perils of windstorm and flood, the maximum deductible is \$20 million. Tropical Storm Allison (2001) losses sustained were not in excess of the \$150 million per occurrence loss limit; however, flooding caused damages in excess of the prior \$5 million sub-limit to Flood Zone A. Insurance reimbursed the City \$32.6 million for property damage resulting from Tropical Storm Allison. Hurricane Ike (2008) losses sustained were not in excess of the \$150 million per occurrence loss limit. Insurance reimbursed the City \$11.4 million for property damage resulting from Hurricane Ike.

The City has a separate terrorism policy which covers insured property value. The policy insures up to \$100 million aggregate loss limit, with a \$10 million per occurrence deductible. The policy provides an aggregate sub-limit of \$25 million for biological and chemical terrorism.

Self-insured claims are reported as liabilities in the accompanying financial statements when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. This determination is based on reported pending claims, estimates of claims incurred but not yet reported, actuarial reports and historical analysis. All claims are accounted for in the Government-wide Statement of Net Assets.

Claims that are expected to be paid with expendable, available financial resources are accounted for in the General Fund and the appropriate Enterprise Funds.

Through its Health Benefit Plan, the City has consistently purchased commercial insurance up to certain limitations in the event of adverse loss experience.



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NOTES TO THE FINANCIAL STATEMENTS

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**12. Commitments and Contingencies, continued:**

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

	<b>Unemployment Claim Activity</b>	
	<b>June 30, 2011</b>	<b>June 30, 2010</b>
Unpaid claims, beginning of fiscal year	\$ 293,224	\$ 196,011
Incurred claims (including IBNRs)	1,897,740	1,303,948
Claim payments	(1,733,534)	(1,206,735)
Unpaid claims, end of fiscal year	<u>\$ 457,430</u>	<u>\$ 293,224</u>

**Electricity Futures Contracts**

At June 30, 2011 the City had entered into agreements to lock rates for part of the natural gas component of its expected electricity use from July 1, 2011 through June 30, 2013. The total committed price is approximately \$132 million for expected usage. The City may pay a different amount if actual electricity usage varies. This amount will be appropriated in future annual budgets.

**13. Subsequent Events****2011A and 2011B Airport System Subordinate Lien Revenue Refunding Bonds**

On July 21, 2011, the City issued Series 2011A (AMT) and Series 2011B (Non-AMT) Airport System Subordinate Lien Revenue Refunding Bonds in the respective amounts of \$449,975,000 and \$116,930,000 for a total of \$566,905,000. Standard & Poor's and Fitch assigned underlying ratings of A and A+, respectively. The City purchased bond insurance from Assured Guaranty Municipal Corp. to cover \$14,495,000 of the Series 2011A bonds maturing July 1, 2015; accordingly, those bonds only were assigned a rating of AA+ by Standard & Poor's at the time of issuance.

The proceeds were used to purchase escrows to refund on a current basis \$537,400,304 of Airport System Subordinate Lien Bonds and to refund on an advanced basis \$58,923,577 of Airport System Subordinate Lien Bonds. The refunded bonds included part of the Airport System's Subordinate Lien 1998A (AMT), 1998B (AMT), 1998C (Non-AMT), 2000A (AMT) and 2002B (Non-AMT) series.

Approximately \$3.90 million of proceeds was used for costs of issuance, bond insurance, and underwriting costs. Interest rates for the 2011 series ranged from 3.00%-5.00%, with a combined true interest cost of 4.09%. As a result of the refunding, the City will lower debt service costs by \$36.2 million on a present value basis. The results of the refunding will be included in the Airport System financial statements and associated debt schedules beginning Fiscal Year 2012.

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**NOTES TO THE FINANCIAL STATEMENTS**

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**13. Subsequent Events, continued:****2011 (AMT) Airport System Special Facilities Revenue Bonds (Continental Airlines, Terminal Improvement Projects)**

The City issued on behalf of Continental Airlines, Inc. its Airport System Special Facilities Revenue Bonds (Continental Airlines, Inc. Terminal Improvement Projects) Series 2011 (AMT) in the principal amount of \$113,305,000. The bond issue is solely an obligation of Continental and does not constitute a debt or pledge of the City or the Fund (that is, the Houston Airport System). Accordingly, the bond issue will not be reported in the accompanying financial statements. The bond transaction closed on November 17, 2011.

The Series 2011 bond issue finances the first phase of the Airlines' capital investment to redevelop Terminal B at Bush Intercontinental Airport. In total, Continental may spend \$686 million across three separate and distinct phases to redevelop Terminal B at Bush Intercontinental Airport. In addition the Airport System is expected to spend about \$288 million on supporting infrastructure and ramp work also across three phases. The Airport System has currently budgeted \$62.2 million to construct its share of phase one of the Terminal B redevelopment.

With the issuance of these bonds a new special facilities lease agreement between the City and the Airline became effective. The new lease transforms the Airport System's Terminal B into a unit terminal whereby the Airline is solely responsible for terminal operating and maintenance expenses and in exchange receives terminal concession revenues. Continental has an obligation to share certain concession net revenues with the Airport System, up to \$1 million annually. The term of the special facilities lease is 30 years, unless extended in certain circumstances. As part of the overall business agreement the Airlines' lease on Terminal C at Bush Intercontinental Airport will eventually be extended to December 31, 2027 and any preferential rights which the Airline had to use certain gates at Terminal D at the Airport have been relinquished.

## REQUIRED PENSION SYSTEM SUPPLEMENTARY INFORMATION

Houston Municipal Pension System Supplementary Information (unaudited)  
Schedule of Funding Progress (in millions)

Actuarial Valuation Date	Actuarial Value of Plan Assets ( a )	Actuarial	Unfunded	Funded Ratio ( a/b )	Projected Annual Covered Payroll ( c )	UAAL as
		Accrued Liability (AAL) Entry Age ( b )	AAL (Surplus UAAL) ( b-a )			Percentage Of Covered Payroll (( b-a)/c )
July 01, 2001	\$1,490.2	\$1,955.8	\$465.6	76%	\$418.0	111%
July 01, 2002	\$1,519.7	\$2,515.2	\$995.5	60%	\$399.8	249%
July 01, 2003	\$1,510.3	\$3,278.3	\$1,768.0	46%	\$390.3	453%
July 01, 2004	\$1,501.2	\$2,633.8	\$1,132.6	57%	\$366.1	309%
July 01, 2005	\$1,777.7	\$2,725.3	\$947.6	65%	\$404.6	234%
July 01, 2006	\$1,867.3	\$2,894.3	\$1,027.0	65%	\$422.5	243%
July 01, 2007	\$2,193.7	\$3,128.7	\$935.0	70%	\$448.9	208%
July 01, 2008	\$2,310.4	\$3,296.4	\$986.0	70%	\$483.8	204%
July 01, 2009	\$2,284.4	\$3,451.4	\$1,167.0	66%	\$539.0	217%
July 01, 2010	\$2,273.1	\$3,632.5	\$1,359.4	63%	\$550.7	247%

Houston Other Post Employment Benefits Supplementary Information (unaudited)  
Schedule of Funding Progress (in millions)

Actuarial Valuation Date	Actuarial Value of Plan Assets ( a )	Actuarial	Unfunded	Funded Ratio ( a/b )	Projected Annual Covered Payroll ( c )	UAAL as
		Accrued Liability (AAL) Entry Age ( b )	AAL (Surplus UAAL) ( b-a )			Percentage Of Covered Payroll (( b-a)/c )
June 30, 2006	\$0.00	\$3,238	\$3,238	0%	\$1,090.1	297%
June 30, 2008	\$0.00	\$3,096	\$3,096	0%	\$1,136.5	272%
June 30, 2009	\$0.00	\$3,031	\$3,031	0%	\$1,193.5	254%
June 30, 2010	\$0.00	\$1,984	\$1,984	0%	\$1,208.9	164%

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COMPREHENSIVE ANNUAL FINANCIAL REPORT

**STATISTICAL SECTION**  
(Unaudited)

## Statistical Section

This section contains statistical information and differs from the financial statements because it usually covers more than one fiscal year and may present non-accounting data.

This information is presented in five categories:

**Financial Trend** – intended to assist users in understanding and assessing how the Houston Airport System’s financial position has changed over time.

**Revenue Capacity** – intended to assist users in understanding and assessing the factors affecting the Houston Airport System’s ability to generate its own source revenues.

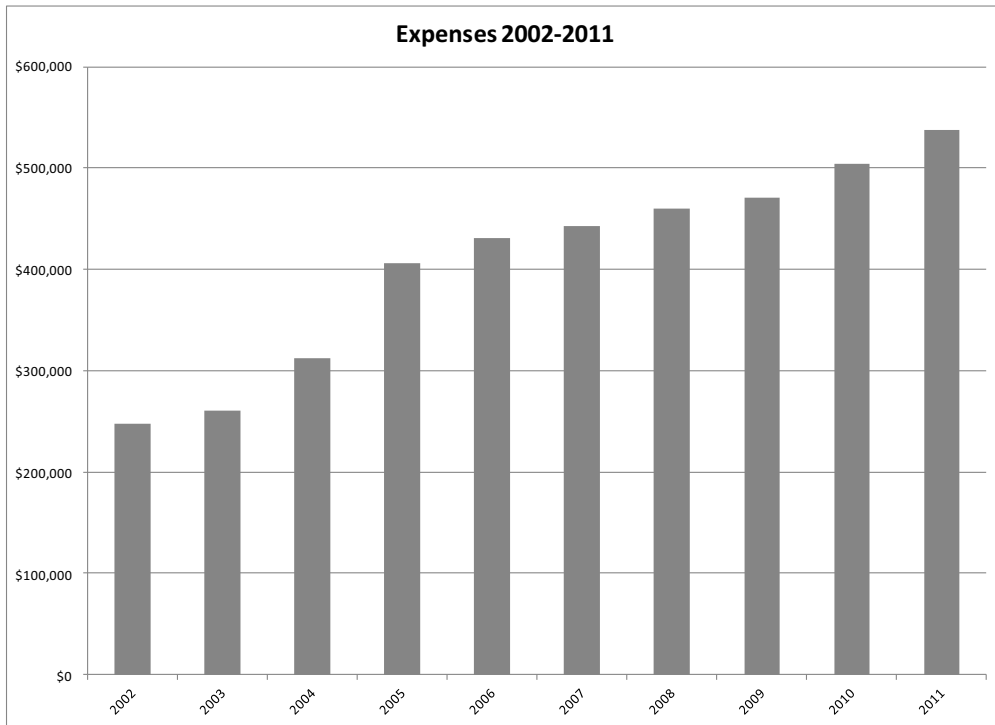
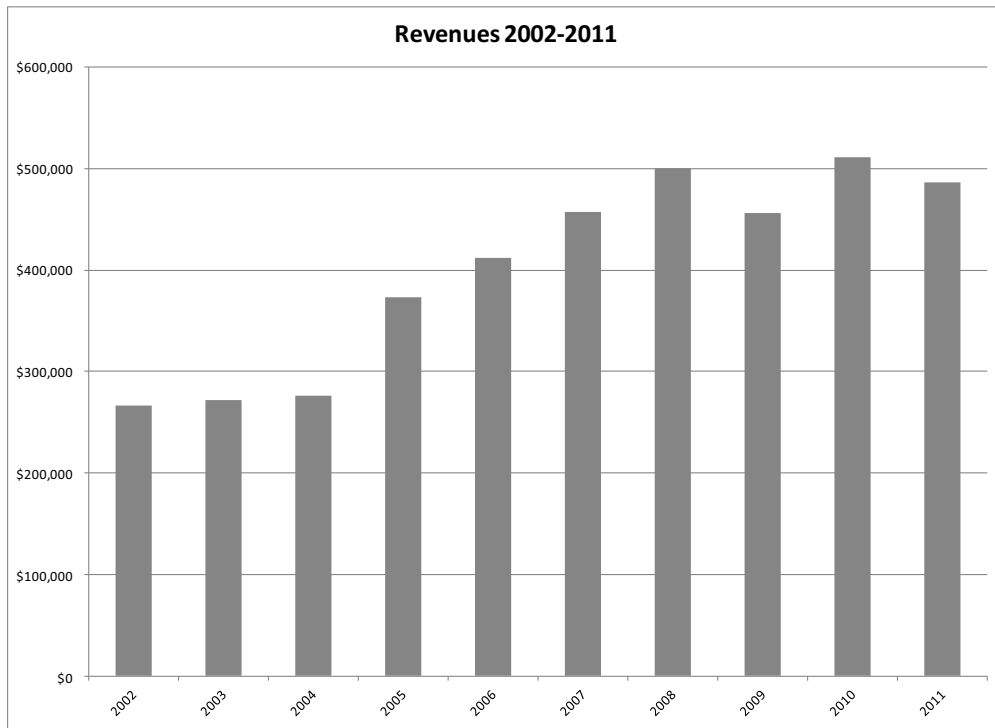
**Debt Capacity** – intended to assist users in understanding and assessing the Houston Airport System’s debt burden and its ability to cover and issue additional debt.

**Operational Information** – intended to provide contextual information about the Houston Airport System’s operations and resources to assist readers in using financial statement information to understand and assess the Houston Airport System economic condition.

**Demographic and Economic** – intended to assist users in understanding the socioeconomic environment within which the Houston Airport System operates and to provide information that facilitates comparisons of financial statement information over time and among similar entities.



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



**TOTAL ANNUAL REVENUE, EXPENSES AND CHANGES IN NET ASSETS (in thousands)**  
**STATISTICAL SECTION**

CHANGE IN NET ASSETS	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>OPERATING REVENUES</b>										
Landing area fees	\$ 50,826	\$ 51,162	\$ 57,011	\$ 102,072	\$ 101,758	\$ 92,140	\$ 99,017	\$ 82,823	\$ 94,165	\$ 90,384
Building and ground area fees	84,752	91,801	115,777	151,417	179,951	199,720	211,786	174,433	182,105	181,182
Concession and parking revenues	91,877	97,804	97,625	100,152	112,152	124,278	136,373	128,501	130,309	138,836
<b>TOTAL OPERATING REVENUES</b>	<b>227,455</b>	<b>240,767</b>	<b>270,413</b>	<b>353,641</b>	<b>393,861</b>	<b>416,138</b>	<b>447,176</b>	<b>385,757</b>	<b>406,579</b>	<b>410,402</b>
<b>NONOPERATING REVENUES</b>										
Interest Income	37,629	30,278	5,967	14,968	18,507	33,722	41,694	37,332	30,487	9,700
Passenger facility charges	-	-	-	-	-	6,530	11,608	32,398	66,383	63,138
Other nonoperating revenues	942	681	203	4,295	56	541	514	1,093	7,525	3,409
<b>TOTAL NONOPERATING REVENUES</b>	<b>38,571</b>	<b>30,959</b>	<b>6,170</b>	<b>19,263</b>	<b>18,563</b>	<b>40,793</b>	<b>53,816</b>	<b>70,823</b>	<b>104,395</b>	<b>76,247</b>
<b>TOTAL REVENUES</b>	<b>266,026</b>	<b>271,726</b>	<b>276,583</b>	<b>372,904</b>	<b>412,424</b>	<b>456,931</b>	<b>500,992</b>	<b>456,580</b>	<b>510,974</b>	<b>486,649</b>
<b>OPERATING EXPENSES</b>										
Maintenance and operating	142,950	154,541	168,923	223,972	202,496	214,611	229,551	241,303	245,051	284,307
Depreciation	60,088	59,987	88,371	105,891	134,150	126,953	125,951	136,554	164,186	163,054
<b>TOTAL OPERATING EXPENSES</b>	<b>203,038</b>	<b>214,528</b>	<b>257,294</b>	<b>329,863</b>	<b>336,646</b>	<b>341,564</b>	<b>355,502</b>	<b>377,857</b>	<b>409,237</b>	<b>447,361</b>
<b>NONOPERATING EXPENSES</b>										
Interest expense and others	44,165	46,538	54,853	75,908	94,586	101,193	104,019	93,376	95,235	89,892
<b>TOTAL NONOPERATING EXPENSES</b>	<b>44,165</b>	<b>46,538</b>	<b>54,853</b>	<b>75,908</b>	<b>94,586</b>	<b>101,193</b>	<b>104,019</b>	<b>93,376</b>	<b>95,235</b>	<b>89,892</b>
<b>TOTAL EXPENSES</b>	<b>247,203</b>	<b>261,066</b>	<b>312,147</b>	<b>405,771</b>	<b>431,232</b>	<b>442,757</b>	<b>459,521</b>	<b>471,233</b>	<b>504,472</b>	<b>537,253</b>
<b>CONTRIBUTIONS</b>	<b>51,286</b>	<b>45,527</b>	<b>42,000</b>	<b>63,989</b>	<b>84,105</b>	<b>41,681</b>	<b>91,175</b>	<b>70,936</b>	<b>51,457</b>	<b>44,135</b>
<b>TOTAL CHANGE IN NET ASSETS</b>	<b>\$ 70,109</b>	<b>\$ 56,187</b>	<b>\$ 6,436</b>	<b>\$ 31,122</b>	<b>\$ 65,297</b>	<b>\$ 55,855</b>	<b>\$ 132,646</b>	<b>\$ 56,283</b>	<b>\$ 57,959</b>	<b>\$ (6,469)</b>
<b>NET ASSETS AT YEAR END</b>										
Invested in capital assets, net of related debt	\$ 690,014	\$ 648,027	\$ 668,742	\$ 695,039	\$ 671,640	\$ 648,933	\$ 685,286	\$ 790,731	\$ 701,767	\$ 663,917
Restricted net assets										
Restricted for debt service	32,281	84,529	40,229	32,267	37,868	53,373	67,847	78,014	156,341	164,162
Restricted for maintenance and operations	28,035	28,123	31,337	34,160	38,322	39,638	41,048	41,899	42,405	43,320
Restricted for renewal and replacement	13,819	13,572	12,947	12,852	10,000	10,000	10,000	10,000	10,000	10,000
Restricted for capital improvement	202,808	251,061	282,494	292,416	376,386	438,127	518,536	458,356	526,446	549,091
Other restricted	1,952	2,092	2,048	2,185	-	-	-	-	-	-
Unrestricted	6,265	3,957	-	-	-	-	-	-	-	-
<b>TOTAL NET ASSETS</b>	<b>\$ 975,174</b>	<b>\$ 1,031,361</b>	<b>\$ 1,037,797</b>	<b>\$ 1,068,919</b>	<b>\$ 1,134,216</b>	<b>\$ 1,190,071</b>	<b>\$ 1,322,717</b>	<b>\$ 1,379,000</b>	<b>\$ 1,436,959</b>	<b>\$ 1,430,490</b>



**PLEGGED REVENUES (in thousands)  
STATISTICAL SECTION**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Net revenues</b>										
Operating revenue	\$ 227,455	\$ 240,767	\$ 270,413	\$ 353,641	\$ 393,861	\$ 416,138	\$ 447,176	\$ 385,757	\$ 406,579	\$ 410,402
Interest on investments - revenue fund	12,816	10,650	8,406	10,499	17,742	26,847	30,064	23,664	15,988	12,889
Other nonoperating revenues	4,449	504	114	3,800	(58)	310	90	300	2,504	341
<b>Gross revenues</b>	<b>244,720</b>	<b>251,921</b>	<b>278,933</b>	<b>367,940</b>	<b>411,545</b>	<b>443,295</b>	<b>477,330</b>	<b>409,721</b>	<b>425,071</b>	<b>423,632</b>
Less: Maintenance and operating expenses	(142,950)	(154,541)	(161,645)	(191,093)	(205,565)	(217,720)	(221,309)	(242,449)	(245,147)	(262,668)
<b>Net pledged revenue</b>	<b>\$ 101,770</b>	<b>\$ 97,380</b>	<b>\$ 117,288</b>	<b>\$ 176,847</b>	<b>\$ 205,980</b>	<b>\$ 225,575</b>	<b>\$ 256,021</b>	<b>\$ 167,272</b>	<b>\$ 179,924</b>	<b>\$ 160,964</b>
Required revenue per bond rate covenant	\$ 56,782	\$ 70,396	\$ 83,382	\$ 123,266	\$ 154,051	\$ 158,450	\$ 172,795	\$ 165,109	\$ 160,138	\$ 176,605
Less grant and PFC revenue available for debt service	(40,868)	(33,310)	(36,106)	(28,057)	(51,283)	(22,747)	(30,825)	(60,161)	(61,196)	(63,557)
<b>Net Required revenue per bond rate covenant</b>	<b>\$ 15,914</b>	<b>\$ 37,086</b>	<b>\$ 47,276</b>	<b>\$ 95,209</b>	<b>\$ 102,768</b>	<b>\$ 135,703</b>	<b>\$ 141,970</b>	<b>\$ 104,948</b>	<b>\$ 98,942</b>	<b>\$ 113,048</b>
<b>Ratio of required revenue</b>	<b>6.39</b>	<b>2.63</b>	<b>2.48</b>	<b>1.86</b>	<b>2.00</b>	<b>1.66</b>	<b>1.80</b>	<b>1.59</b>	<b>1.82</b>	<b>1.42</b>
<b>Debt Service</b>										
Principal	\$ 4,380	\$ 17,985	\$ 18,865	\$ 28,182	\$ 31,737	\$ 33,377	\$ 45,996	\$ 49,692	\$ 51,832	\$ 61,136
Interest	47,231	46,003	56,932	84,066	108,700	110,834	111,306	100,822	93,635	97,705
	51,611	63,988	75,797	112,248	140,437	144,211	157,302	150,514	145,467	158,841
Less grant and PFC revenue available for debt service	(37,153)	(30,282)	(32,823)	(25,506)	(46,621)	(20,679)	(28,022)	(54,963)	(56,171)	(56,827)
<b>Total debt service</b>	<b>\$ 14,458</b>	<b>\$ 33,706</b>	<b>\$ 42,974</b>	<b>\$ 86,742</b>	<b>\$ 93,816</b>	<b>\$ 123,532</b>	<b>\$ 129,280</b>	<b>\$ 95,551</b>	<b>\$ 89,296</b>	<b>\$ 102,014</b>
<b>Coverage of debt service</b>	<b>7.04</b>	<b>2.89</b>	<b>2.73</b>	<b>2.04</b>	<b>2.20</b>	<b>1.83</b>	<b>1.98</b>	<b>1.75</b>	<b>2.01</b>	<b>1.58</b>

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

Debt service requirements is equal to interest expense (excluding amortization of bond discount and amounts provided for payment of interest from bond proceeds and other sources and deposited into restricted fund for that purpose) for each respective fiscal year ended June 30, plus principal payment payable on the next July 1. Certain grant revenue and passenger facility charge revenue is available to cover net required revenue and required debt service.

Fiscal Year 2011 includes \$19,384,073 in prior year planning and repair expense, and canceled projects, reclassified from capital assets.

(continued)

**PLEGGED REVENUES (in thousands), continued:  
STATISTICAL SECTION**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Net revenues</b>										
Operating revenue	\$ 227,455	\$ 240,767	\$ 270,413	\$ 353,641	\$ 393,861	\$ 416,138	\$ 447,176	\$ 385,757	\$ 406,579	\$ 410,402
Interest on investments - revenue fund	12,816	10,650	8,406	10,499	17,742	26,847	30,064	23,664	15,988	12,889
Other operating revenues	4,449	504	114	3,800	(58)	310	90	300	2,504	341
<b>Gross revenues</b>	<b>244,720</b>	<b>251,921</b>	<b>278,933</b>	<b>367,940</b>	<b>411,545</b>	<b>443,295</b>	<b>477,330</b>	<b>409,721</b>	<b>425,071</b>	<b>423,632</b>
Less: Maintenance and operating expenses	(142,950)	(154,541)	(161,645)	(191,093)	(205,565)	(217,720)	(221,309)	(242,449)	(245,147)	(262,668)
<b>Net pledged revenue</b>	<b>\$ 101,770</b>	<b>\$ 97,380</b>	<b>\$ 117,288</b>	<b>\$ 176,847</b>	<b>\$ 205,980</b>	<b>\$ 225,575</b>	<b>\$ 256,021</b>	<b>\$ 167,272</b>	<b>\$ 179,924</b>	<b>\$ 160,964</b>
<b>Required revenue per bond rate covenant:</b>										
Senior lien requirement	\$ 84	\$ 72	\$ 41	\$ 793	\$ 1,858	\$ 3,495	\$ 2,842	\$ 1,855	\$ 5,972	\$ 6,937
Senior lien coverage	1211.55	1352.50	2860.68	223.01	110.86	64.54	90.08	90.17	30.13	23.20
Net revenue after senior lien requirements	\$ 101,686	\$ 97,308	\$ 117,247	\$ 176,054	\$ 204,122	\$ 222,080	\$ 253,179	\$ 165,417	\$ 173,952	\$ 154,027
Subordinate lien requirement	\$ 15,831	\$ 37,014	\$ 47,235	\$ 91,399	\$ 94,384	\$ 126,190	\$ 132,811	\$ 99,918	\$ 92,970	\$ 106,111
Subordinate lien coverage	6.42	2.63	2.48	1.93	2.16	1.76	1.91	1.66	1.87	1.45
Net revenue after senior and sub lien requirements	\$ 85,855	\$ 60,294	\$ 70,012	\$ 84,655	\$ 109,738	\$ 95,890	\$ 120,368	\$ 65,499	\$ 80,982	\$ 47,916
Inferior lien requirement	-	-	-	3,017	6,526	6,018	6,317	3,175	-	-
<b>Net revenue after pledged debt requirements</b>	<b>\$ 85,855</b>	<b>\$ 60,294</b>	<b>\$ 70,012</b>	<b>\$ 81,638</b>	<b>\$ 103,212</b>	<b>\$ 89,872</b>	<b>\$ 114,051</b>	<b>\$ 62,324</b>	<b>\$ 80,982</b>	<b>\$ 47,916</b>

**OUTSTANDING DEBT (in thousands)**  
**STATISTICAL SECTION**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Outstanding debt by type</b>										
Current Liabilities										
Revenue bonds payable	\$ 4,380	\$ 17,985	\$ 18,865	\$ 27,665	\$ 28,385	\$ 34,500	\$ 43,050	\$ 40,840	\$ 47,335	\$ 52,285
Inferior lien contract payable	-	-	-	3,255	3,450	3,660	3,880	4,085	4,305	4,535
Commercial paper payable	-	-	20,000	-	-	-	-	-	6,000	-
<b>Total current liabilities</b>	<b>4,380</b>	<b>17,985</b>	<b>38,865</b>	<b>30,920</b>	<b>31,835</b>	<b>38,160</b>	<b>46,930</b>	<b>44,925</b>	<b>57,640</b>	<b>56,820</b>
Long-term Liabilities										
Revenue bonds payable	\$ 1,484,860	\$ 2,191,380	\$ 2,172,515	\$ 2,146,205	\$ 2,117,820	\$ 2,083,320	\$ 2,083,255	\$ 2,042,415	\$ 2,440,090	\$ 2,388,735
Inferior lien contract payable	-	-	-	56,810	53,360	49,700	45,820	41,735	37,430	32,895
Commercial paper payable	20,000	-	-	48,500	59,000	95,000	83,000	93,000	-	-
<b>Total long-term liabilities</b>	<b>1,504,860</b>	<b>2,191,380</b>	<b>2,172,515</b>	<b>2,251,515</b>	<b>2,230,180</b>	<b>2,228,020</b>	<b>2,212,075</b>	<b>2,177,150</b>	<b>2,477,520</b>	<b>2,421,630</b>
<b>Total outstanding debt</b>	<b>\$ 1,509,240</b>	<b>\$ 2,209,365</b>	<b>\$ 2,211,380</b>	<b>\$ 2,282,435</b>	<b>\$ 2,262,015</b>	<b>\$ 2,266,180</b>	<b>\$ 2,259,005</b>	<b>\$ 2,222,075</b>	<b>\$ 2,535,160</b>	<b>\$ 2,478,450</b>
<b>Total enplaned passengers</b>	<b>20,941,865</b>	<b>20,604,509</b>	<b>21,779,196</b>	<b>23,357,155</b>	<b>24,912,085</b>	<b>25,830,387</b>	<b>26,202,152</b>	<b>24,030,602</b>	<b>24,531,054</b>	<b>24,944,816</b>
<b>Outstanding debt per enplaned passenger</b>	<b>\$ 72.07</b>	<b>\$ 107.23</b>	<b>\$ 101.54</b>	<b>\$ 97.72</b>	<b>\$ 90.80</b>	<b>\$ 87.73</b>	<b>\$ 86.21</b>	<b>\$ 92.47</b>	<b>\$ 103.34</b>	<b>\$ 99.36</b>

**SUMMARY OF CERTAIN FEES AND CHARGES  
STATISTICAL SECTION**

<b>IAH</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Landing Rates (1)	1.518	1.651	1.654	3.164	3.190	3.069	2.928	2.948	2.953	2.790
Terminal Space Rentals (2)	22.54-45.76	24.36-53.83	18.92-62.19	20.69-92.74	19.28-86.56	25.32-99.05	27.52-112.85	27.06-93.85	23.74-71.84	22.13-80.64
Apron Rentals (2)	1.133-2.454	1.296-2.903	1.465-3.094	1.652-3.339	1.759-3.243	2.373-3.636	2.443-2.889	2.265-2.865	1.992-2.129	2.006-2.775
Parking Rates (3)										
Economy (Ecopark) Uncovered	5.00-6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	5.00
Economy (Ecopark) Covered										7.00
Structured	10.00-12.00	12.00	12.00	12.00	13.00	13.00	15.00	15.00	17.00	17.00
Surface	7.00-9.00	9.00	9.00	9.00	-	-	-	-	-	-
Short-Term	30.00	30.00	30.00	30.00	-	-	-	-	-	-
Sure Park	15.00	15.00	15.00	15.00	15.00	15.00	15.00	15.00	20.00	20.00
<b>HOU</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Landing Rates (1)	1.905	2.078	2.232	2.587	2.711	2.814	2.255	2.186	2.322	2.094
Terminal Space Rentals (2)	35.63-56.68	35.19-54.82	34.41-60.69	40.73-67.24	42.90-73.02	40.39-72.44	86.07-91.45	94.18-94.36	92.74-106.58	96.79-99.29
Apron Rentals (2)	1.936	1.831	2.019-3.468	2.628-3.626	2.529-3.722	2.477-3.245	2.288	2.202	2.161	1.867
Parking Rates (3)										
Economy (Ecopark) 1	5.00-6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	8.00	8.00
Economy (Ecopark) 2										6.00
Structured	10.00-12.00	12.00	12.00	12.00	13.00	13.00	15.00	15.00	17.00	17.00
Surface	-	-	-	-	-	-	-	-	-	-
Short-Term	30.00	30.00	30.00	30.00	-	-	-	-	-	-
Sure Park	-	-	-	-	-	-	-	-	-	-

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

**PASSENGER STATISTICS  
LAST TEN YEARS**

Fiscal Year	Domestic Passengers					
	Intercontinental		Hobby		Ellington Airport	
	Enplanements	Percentage Change	Enplanements	Percentage Change	Enplanements	Percentage Change
	& Deplanements (in thousands)		& Deplanements (in thousands)		& Deplanements (in thousands)	
2002	28,168	-6.4%	8,192	-9.4%	68	6.3%
2003	27,931	-0.8%	7,796	-4.8%	81	19.1%
2004	29,473	5.5%	8,089	3.8%	80	-1.2%
2005	31,609	7.2%	8,247	2.0%	14	-82.5%
2006	34,105	7.9%	8,423	2.1%	-	-100.0%
2007	35,260	3.4%	8,642	2.6%	-	-
2008	35,200	-0.2%	9,097	5.3%	-	-
2009	31,995	-9.1%	8,286	-8.9%	-	-
2010	32,093	0.3%	8,755	5.7%	-	-
2011	31,666	-1.3%	9,434	7.8%	-	-

Fiscal Year	Domestic Passengers		International Passengers		Total Passengers	
	Total		Intercontinental		Enplanements & Deplanements (in thousands)	Percentage Change
	Enplanements	Percentage Change	Enplanements	Percentage Change		
	& Deplanements (in thousands)		& Deplanements (in thousands)			
2002	36,428	-7.1%	5,556	-4.4%	41,984	-6.7%
2003	35,808	-1.7%	5,526	-0.5%	41,334	-1.5%
2004	37,642	5.1%	5,952	7.7%	43,594	5.5%
2005	39,870	5.9%	6,818	14.5%	46,688	7.1%
2006	42,528	6.7%	7,126	4.5%	49,654	6.4%
2007	43,902	3.2%	7,555	6.0%	51,457	3.6%
2008	44,297	0.9%	7,976	5.6%	52,273	1.6%
2009	40,281	-9.1%	7,642	-4.2%	47,923	-8.3%
2010	40,848	1.4%	8,139	6.5%	48,987	2.2%
2011	41,100	0.6%	8,732	7.3%	49,832	1.7%

**PASSENGER STATISTICS BY CARRIER TOTAL  
FOR YEARS ENDED JUNE 30, 2011 AND 2010**

Airlines	Intercontinental				Hobby			
	Fiscal Year 2010		Fiscal Year 2011		Fiscal Year 2010		Fiscal Year 2011	
	Total Passengers (in thousands)	Market Share	Total Passengers (in thousands)	Market Share	Total Passengers (in thousands)	Market Share	Total Passengers (in thousands)	Market Share
Alaska Airlines	65,313	0.2%	90,976	0.2%	-	0.0%	-	0.0%
Air Tran	-	0.0%	-	0.0%	334,988	3.8%	407,703	4.3%
America West	-	0.0%	-	0.0%	-	0.0%	-	0.0%
American Airlines, Inc.	736,072	1.8%	719,228	1.8%	-	0.0%	-	0.0%
American Eagle - AA	99,970	0.2%	171,519	0.4%	234,427	2.7%	206,761	2.2%
Atlantic Southeast - DL	55,564	0.1%	113,068	0.3%	93,262	1.1%	123,063	1.3%
Charter Airlines	7,354	0.0%	8,891	0.0%	9,432	0.1%	14,446	0.2%
Chautauqua Airlines - CO	475,140	1.2%	369,304	0.9%	-	0.0%	-	0.0%
Colgan - Air Inc. - CO	524,431	1.3%	802,826	2.0%	-	0.0%	-	0.0%
Comair - DL	86,609	0.2%	77,038	0.2%	1,542	0.0%	-	0.0%
Compass Airlines - DL	70,513	0.2%	102,155	0.3%	2,516	0.0%	441	0.0%
Continental	19,524,402	48.6%	19,214,288	47.7%	-	0.0%	-	0.0%
Delta	462,501	1.1%	422,809	1.0%	3,008	0.0%	89,279	0.9%
Executives - AA	-	0.0%	-	0.0%	30,945	0.4%	-	0.0%
ExpressJet Airlines, Inc.	7,501,514	18.7%	6,792,429	16.9%	-	0.0%	-	0.0%
ExpressJet -Branson Air	-	0.0%	-	0.0%	-	0.0%	3,983	0.0%
Frontier	224,423	0.6%	87,044	0.2%	-	0.0%	122,692	1.3%
JetBlue	-	0.0%	-	0.0%	150,044	1.7%	141,149	1.5%
Mesa Airlines, Inc. - UA	27,647	0.1%	5,214	0.0%	-	0.0%	-	0.0%
Mesa Airlines, Inc. - US	14,603	0.0%	9,243	0.0%	-	0.0%	-	0.0%
Mesaba Aviation, Inc. - DL	159,885	0.4%	211,150	0.5%	-	0.0%	-	0.0%
Pinnacle Airlines, Inc. - DL	-	0.0%	-	0.0%	176,864	2.0%	110,939	1.2%
Pinnacle Airlines, Inc. - NW	159,926	0.4%	121,252	0.3%	-	0.0%	-	0.0%
Republic Airlines - US	146,741	0.4%	149,140	0.4%	-	0.0%	-	0.0%
Shuttle America Corporation - CO	-	0.0%	3,027	0.0%	-	0.0%	-	0.0%
Shuttle America Corporation - DL	21,744	0.1%	-	0.0%	22,126	0.3%	5,749	0.1%
Shuttle America Corporation - UA	72,106	0.2%	52,628	0.1%	-	0.0%	-	0.0%
SkyWest Airlines - CO	-	0.0%	418,090	1.0%	-	0.0%	-	0.0%
SkyWest Airlines - DL	211,361	0.5%	130,023	0.3%	8,397	0.1%	5,562	0.1%
SkyWest Airlines - UA	48,821	0.1%	139,858	0.3%	-	0.0%	-	0.0%
Southwest Airlines Company	-	0.0%	-	0.0%	7,687,170	87.8%	8,202,622	86.9%
United Air Lines Inc.	619,122	1.5%	567,832	1.4%	-	0.0%	-	0.0%
US Airways	777,568	1.9%	887,186	2.2%	-	0.0%	-	0.0%
<b>Total Domestic</b>	<b>32,093,330</b>	<b>79.8%</b>	<b>31,666,218</b>	<b>78.4%</b>	<b>8,754,721</b>	<b>100.0%</b>	<b>9,434,389</b>	<b>100.0%</b>

Airlines	Fiscal Year 2010		Fiscal Year 2011		Fiscal Year 2010		Fiscal Year 2011	
	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share	Total Passengers	Market Share
	AeroMexico	138,063	0.3%	191,603	0.5%			
Air Canada Jazz	189,385	0.5%	233,147	0.6%				
Air France	163,358	0.4%	147,048	0.4%				
Atlas Air	-	0.0%	24,009	0.1%				
British Airways	220,658	0.5%	245,119	0.6%				
Charter Airlines	2,227	0.0%	2,178	0.0%				
Continental	5,303,028	13.3%	5,809,580	14.3%				
Emirates	163,269	0.4%	220,534	0.5%				
ExpressJet Airlines, Inc.	1,291,483	3.3%	1,074,597	2.7%				
KLM	177,245	0.4%	179,274	0.4%				
Lufthansa	196,349	0.5%	212,202	0.5%				
Qatar Airways	135,802	0.3%	146,162	0.4%				
Shuttle America Corporation - CO	-	0.0%	2,444	0.0%				
Shuttle America Corporation - UA	-	0.0%	4,867	0.0%				
Singapore Airlines	80,784	0.2%	117,375	0.3%				
SkyWest Airlines - CO	-	0.0%	9,301	0.0%				
TACA	57,147	0.1%	48,529	0.1%				
United Air Lines Inc.	-	0.0%	43,889	0.1%				
Viva Aerobus	-	0.0%	20,435	0.1%				
World Airways	19,684	0.0%	-	0.0%				
<b>Total International</b>	<b>8,138,482</b>	<b>20.2%</b>	<b>8,732,293</b>	<b>21.6%</b>				

<b>Total Airlines</b>	<b>40,231,812</b>	<b>100.0%</b>	<b>40,398,511</b>	<b>100.0%</b>	<b>8,754,721</b>	<b>100.0%</b>	<b>9,434,389</b>	<b>100.0%</b>
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Domestic only

(continued)



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**ORIGINATING PASSENGER ENPLANEMENTS  
STATISTICAL SECTION**


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**George Bush Intercontinental Airport**

Fiscal Year	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
2002	7,934,632	8,876,817	16,811,449	47.2%
2003	7,820,907	8,842,781	16,663,688	46.9%
2004	8,626,935	9,066,201	17,693,136	48.8%
2005	9,326,276	9,872,313	19,198,589	48.6%
2006	9,983,652	10,692,215	20,675,867	48.3%
2007	10,477,803	11,008,827	21,486,630	48.8%
2008	10,449,631	11,190,625	21,640,256	48.3%
2009	9,190,724	10,680,955	19,871,679	46.3%
2010	9,278,705	10,854,946	20,133,651	46.1%
2011	9,696,972	10,508,661	20,205,633	48.0%

**William P. Hobby Airport**

Fiscal Year	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
2002	3,166,701	927,932	4,094,633	77.3%
2003	2,994,073	904,483	3,898,556	76.8%
2004	3,103,828	940,732	4,044,560	76.7%
2005	3,236,719	914,007	4,150,726	78.0%
2006	3,313,974	922,244	4,236,218	78.2%
2007	3,396,182	947,575	4,343,757	78.2%
2008	3,605,540	956,631	4,562,171	79.0%
2009	3,322,678	836,245	4,158,923	79.9%
2010	3,343,393	1,054,010	4,397,403	76.0%
2011	3,617,541	1,121,642	4,739,183	76.3%

**Ellington Field**

Fiscal Year	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
2002	35,783	-	35,783	100.0%
2003	42,265	-	42,265	100.0%
2004	41,500	-	41,500	100.0%
2005	7,840	-	7,840	100.0%
2006	-	-	-	0.0%
2007	1	-	1	100.0%
2008	-	-	-	0.0%
2009	-	-	-	0.0%
2010	1	-	1	100.0%
2011	-	-	-	0.0%

\*\* Commercial passenger service ceased in September 2005.

**Houston Airport System**

Fiscal Year	Originating Enplanements	Connecting Enplanements	Total Enplaned Passengers	Originating Enplanement Percentage
2002	11,137,116	9,804,749	20,941,865	53.2%
2003	10,857,245	9,747,264	20,604,509	52.7%
2004	11,772,263	10,006,933	21,779,196	54.1%
2005	12,570,835	10,786,320	23,357,155	53.8%
2006	13,297,626	11,614,459	24,912,085	53.4%
2007	13,873,986	11,956,402	25,830,388	53.7%
2008	14,055,171	12,147,256	26,202,427	53.6%
2009	12,513,402	11,517,200	24,030,602	52.1%
2010	12,622,099	11,908,956	24,531,055	51.5%
2011	13,314,513	11,630,303	24,944,816	53.4%



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**AIRCRAFT OPERATIONS AND LANDING WEIGHT  
STATISTICAL SECTION**


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Fiscal Year	Aircraft Operations (in thousands)			Aircraft Landed Weight (in million pounds)		
	Total	Increase (Decrease)	Percentage Change	Total	Increase (Decrease)	Percentage Change
2002	790	(33)	-4.01%	30,496	(1,587)	-4.95%
2003	811	21	2.66%	30,802	306	1.00%
2004	856	45	5.55%	31,444	642	2.08%
2005	887	31	3.62%	32,543	1,099	3.50%
2006	933	46	5.19%	32,808	265	0.81%
2007	983	50	5.36%	33,930	1,122	3.42%
2008	974	(9)	-0.92%	34,097	167	0.49%
2009	892	(82)	-8.42%	31,907	(2,190)	-6.42%
2010	858	(34)	-3.81%	31,662	(245)	-0.77%
2011	861	3	0.35%	32,564	902	2.85%

**PERFORMANCE MEASURES  
STATISTICAL SECTION**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Revenue per Enplaned Passenger	\$ 12.70	\$ 13.19	\$ 12.70	\$ 15.97	\$ 16.56	\$ 17.69	\$ 19.12	\$ 19.00	\$ 20.83	\$ 19.51
Maintenance and Operations Expenses per Enplaned Passenger	\$ 6.83	\$ 7.50	\$ 7.76	\$ 9.59	\$ 8.13	\$ 8.31	\$ 8.76	\$ 10.04	\$ 9.99	\$ 11.40
Debt Service per Enplaned Passenger	\$ 2.46	\$ 3.11	\$ 3.48	\$ 4.81	\$ 5.64	\$ 5.58	\$ 6.00	\$ 6.26	\$ 5.93	\$ 6.37
Outstanding Debt per Enplaned Passenger	\$ 72.07	\$ 107.23	\$ 101.54	\$ 97.72	\$ 90.80	\$ 87.73	\$ 86.21	\$ 92.47	\$ 103.34	\$ 99.36
Intercontinental Budgeted Airline Cost per Est. Enplaned Passenger (1)	\$ 5.34	\$ 6.47	\$ 7.17	\$ 10.25	\$ 11.54	\$ 11.34	\$ 11.26	\$ 11.04	\$ 11.06	\$ 10.42
Intercontinental Actual Airline Cost per Enplaned Passenger (1)	\$ 5.59	\$ 6.49	\$ 6.96	\$ 10.27	\$ 10.38	\$ 10.56	\$ 11.03	\$ 11.53	\$ 10.52	\$ -
Hobby Budgeted Airline Cost per Est. Enplaned Passenger (1)	\$ 5.02	\$ 5.81	\$ 7.57	\$ 8.49	\$ 8.52	\$ 8.26	\$ 8.40	\$ 8.20	\$ 9.44	\$ 7.99
Hobby Actual Airline Cost per Enplaned Passenger (1)	\$ 5.10	\$ 6.32	\$ 7.35	\$ 8.23	\$ 6.95	\$ 7.83	\$ 7.79	\$ 8.64	\$ 8.75	\$ -

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

**AIRPORT INFORMATION  
STATISTICAL SECTION**

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George Bush Intercontinental Airport

Location:	22 miles north of downtown Houston		
Area:	10,030 acres		
Elevation:	97 MSL		
Airport Code:	IAH		
Runways:	8R-26L	9,402 x 150 ft	
	9-27	10,000 x 150 ft	
	15L-33R	12,001 x 150 ft	
	15R-33L	9,999 x 150 ft	
	8L-26R	9,000 x 150 ft	
Terminal:	Airlines		2,748,820 sf
	Tenants		191,848 sf
	Public / Common		744,699 sf
	Mechanical		262,032 sf
	Other		<u>278,114 sf</u>
	Total		4,225,513 sf
	Number of gates		116
	Number of hardstand positions		21
	Apron for Commercial Airlines		4,075,799 sf
Consolidated Rental Car Facility:	Number of rental car agencies		8
Parking:	Spaces Assigned:	Short-term hourly	12,979
		Long-term economy	8,553
		Employee	<u>1,629</u>
		Total	23,161

**AIRPORT INFORMATION  
STATISTICAL SECTION**

William P. Hobby Airport

Location:	7 miles southeast of downtown Houston		
Area:	1,524 acres		
Elevation:	46 MSL		
Airport Code:	HOU		
Runways:	12L-30R	5,148 x 150 ft	
	12R-30L	7,602 x 150 ft	
	17-35	6,000 x 150 ft	
	4-22	7,602 x 150 ft	
Terminal:	Airlines		281,439 sf
	Tenants		41,519 sf
	Public / Common		140,990 sf
	Mechanical		48,095 sf
	Other		<u>41,992 sf</u>
	Total		554,035 sf
	Number of gates		25
	Apron for Commercial Airlines		681,239 sf
Consolidated Rental Car Facility:	Number of rental car agencies		9
Parking:	Spaces Assigned:	Short-term hourly	2,836
		Long-term economy	922
		Employee	<u>940</u>
		Total	4,698

Ellington Airport (1)

Location:	15 miles southeast of downtown Houston		
Area:	1,984 acres		
Elevation:	32 MSL		
Airport Code:	EFD		
Runways:	17L-35R	4,609 x 75 ft	
	17R-35L	9,001 x 150 ft	
	4-22	8,001 x 150 ft	

Note 1: No scheduled commercial flights.

**EMPLOYEE STAFFING BY FUNCTION  
STATISTICAL SECTION**

Department	Full time Equivalent (FTE) Number of Employees (1)				
	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Executive Administration	8.7	9.0	8.6	6.0	7.1
F&A Administration	18.0	11.0	14.2	16.8	16.5
Finance	50.5	51.7	52.3	44.0	43.1
Human Resources	34.1	32.0	34.3	33.8	22.6
Purchasing	77.7	76.6	73.8	71.6	68.2
Property Management	10.8	9.1	9.1	11.7	20.2
Marketing, Communications & Community Affairs	17.4	16.2	17.3	23.5	29.2
Airports Services	16.9	21.3	24.0	22.2	4.0
George Bush Intercontinental (IAH) Operations (2)	719.3	689.0	674.2	642.4	629.7
William P. Hobby (HOU) Operations (2)	245.6	240.6	252.2	241.8	229.3
Ellington Airport Operations (2)	29.0	28.9	30.7	30.5	30.8
Security and Safety-All Airports (3)	295.0	291.9	290.2	272.5	287.4
Planning, Design & Construction	65.6	68.0	72.1	76.1	94.1
Information Technology	34.1	41.9	51.8	51.8	44.3
Total FTE Employees	<u>1,622.7</u>	<u>1,587.2</u>	<u>1,604.8</u>	<u>1,544.7</u>	<u>1,526.5</u>

Note 1: A full-time employee is scheduled to work 2,080 hours per year (including vacation and sick leave). Full time equivalent employment is calculated by dividing total labor hours including overtime by 2,080.

Note 2: Includes Airside, Landside, Communication Center and Ground Transportation.

Note 3: Police and Fire Operations are not included in employee counts for the Houston Airport System. They are provided by the City of Houston and paid for through interfund service charges. See Note #9 in the Notes to the Financial Statements.

The Fund is including only five years of employee staffing information because of a change in cost center allocations during the implementation of a new accounting system in fiscal year 2007.

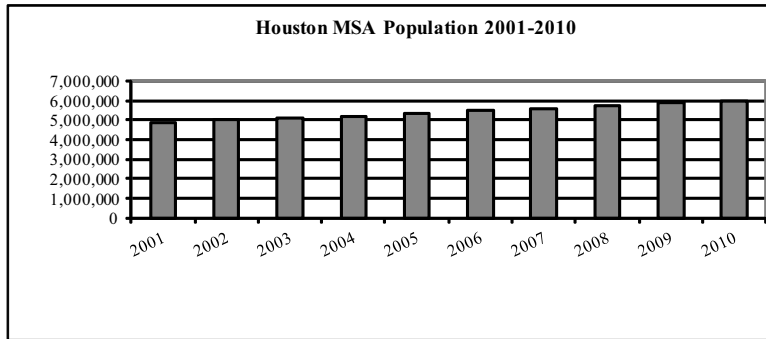
**SERVICE AREA  
STATISTICAL SECTION**

The primary service region for the Houston Airport System, the 10-county Houston-Sugar Land-Baytown, Texas Metropolitan Statistical Area ("MSA"), has a diverse economic base and is recognized as a major national and international energy, financial, medical, transportation, retail, and distribution center. The MSA extends out two additional counties for the broader Houston-Baytown-Huntsville Combined Statistical Area ("CSA"). According to U.S. Bureau of the Census, the population estimate was 5.95 million for the MSA and 6.05 million for the CSA as of July 1, 2010. The air service region also encompasses other smaller markets such as Beaumont/Port Arthur, Victoria, Brownsville and Del Rio in Texas and Lake Charles, Louisiana as those airports only provide air service to and from Intercontinental.

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

**Service Area Population**

<u>Year</u>	<u>Houston MSA Population</u>
2001	4,851,189
2002	4,978,638
2003	5,084,017
2004	5,190,444
2005	5,299,567
2006	5,484,883
2007	5,597,674
2008	5,726,705
2009	5,867,489
2010	5,946,800



Source: Greater Houston Partnership and U.S. Census Bureau, Population Division

**Largest Private Employers Houston MSA**

At June 30, 2011

Memorial Hermann Healthcare Systems  
 United Continental Holdings  
 The University of Texas, M.D. Anderson  
 Exxon Mobil  
 Shell Oil Company

The Methodist Hospital System  
 United Space Alliance  
 Schlumberger Limited  
 National Oilwell Varco  
 Baylor College of Medicine

Sources: Greater Houston Partnership; Business Houston

## APPENDIX B-1

### THE ORDINANCE

*The following are summaries of certain provisions of and certain defined terms contained in the Ordinance or used in this Official Statement. These summaries do not purport to be comprehensive or definitive and are qualified in their entirety by reference to the full terms of the Ordinance. Additional summaries of certain provisions of the Ordinance are included in the forepart of the Official Statement under the caption "THE SERIES 2012 BONDS."*

### SUMMARY OF SELECTED PROVISIONS

#### Funds

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

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

The Senior Lien Bond Interest and Sinking Fund constitute trust funds which are to be held in trust for the Owners of the Senior Lien Obligations to which they are pledged, and the proceeds of which (other than the interest income thereon, which may be transferred to the Revenue Fund or such other Funds as may be required under federal tax law) shall be pledged to the payment of the Senior Lien Obligations. The Senior Lien Bond Reserve Fund and the accounts created therein are pledged to the particular Senior Lien Obligations, as described in the ordinances authorizing the issuance of the Senior Lien Obligations.

The Subordinate Lien Bond Interest and Sinking Fund shall constitute trust funds which shall be held in trust for the Owners of the Subordinate Lien Bonds to which they are pledged and the proceeds of which (other than the interest income thereon, which may be transferred to the Revenue Fund or such other Funds as may be required under federal tax law) shall be pledged to the payment of such Subordinate Lien Bonds.

The Subordinate Lien Bond Reserve Fund shall constitute trust funds which shall be held in trust for the Owners of the Subordinate Lien Bonds to which they are pledged and the proceeds of which (other than the interest income thereon, which may be transferred to the extent herein provided to the Subordinate Lien Bond Interest and Sinking Fund or such other funds as may be permitted under federal tax law) shall be pledged to the payment of the Subordinate Lien Bonds. Within the Subordinate Lien Bond Reserve Fund, there shall be created a Subordinate Lien Bond Reserve Fund Participant Account, which account shall constitute trust funds and shall be held in trust for Owners of the Subordinate Lien Bonds that are Reserve Fund Participants. The proceeds of the Subordinate Lien Bond Reserve Fund Participant Account (other than the interest income thereon, which may be transferred to the extent herein provided to the Subordinate Lien Bond Interest and Sinking Fund or such other funds as may be permitted under federal tax law) shall be pledged to the payment of the Subordinate Lien Bonds that are Reserve Fund Participants. The City may issue Additional Subordinate Lien Bonds which may be designated as Reserve Fund Participants. The City also reserves the right to issue Additional Subordinate Lien Bonds which are not designated as Reserve Fund Participants and are not secured by the Subordinate Lien Bond Reserve Fund Participant Account; provided that the City may create a separate account(s) within the Subordinate Lien Bond Reserve Fund for the benefit of any such series that is not a Reserve Fund Participant, the proceeds of which account (other than the interest thereon, which may be transferred as set forth in the Ordinance) shall be pledged to the payment of such series that is not a Reserve Fund Participant.

The City has also reserved the right to create additional accounts within any Fund as necessary or desirable in furtherance of the intent and purpose of the Ordinance, including the purpose of causing the supplemental funding of any reserve fund.

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

- (1) First, to pay and to provide by encumbrance for the payment of all current Operation and Maintenance Expenses;
- (2) Second, to transfer all amounts to the Senior Lien Bond Interest and Sinking Fund required by any ordinance authorizing the issuance of Senior Lien Bonds or Senior Lien Notes;
- (3) Third, to transfer all amounts to the Senior Lien Bond Reserve Fund required by any ordinance authorizing the issuance of Senior Lien Bonds or Senior Lien Notes, including transfers to pay all reimbursement obligations under any reserve fund surety policies obtained with respect to Senior Lien Bonds or Senior Lien Notes;
- (4) Fourth, to transfer all amounts to the Subordinate Lien Bond Interest and Sinking Fund required by the Ordinance and any ordinance authorizing the issuance of Subordinate Lien Bonds;
- (5) Fifth, to transfer all amounts to the Subordinate Lien Bond Reserve Fund required by the Ordinance and any ordinance authorizing the issuance of Subordinate Lien Bonds, including transfers to pay all reimbursement obligations under any reserve fund surety policies obtained with respect to the Subordinate Lien Bonds;
- (6) Sixth, to transfer all amounts necessary to provide for the payment, and/or to provide reserves for the payment, of principal of, premium, if any, and interest on any Inferior Lien Bonds to the appropriate funds or accounts established for such purpose and required to be maintained by any ordinance authorizing such Inferior Lien Bonds;
- (7) Seventh, to transfer all amounts to the Operation and Maintenance Reserve Fund required by the Ordinance and any other ordinance authorizing Senior Lien Obligations, Subordinate Lien Bonds or Inferior Lien Bonds;
- (8) Eighth, to transfer all amounts to the Renewal and Replacement Fund required by the Ordinance and any other ordinance authorizing Senior Lien Obligations, Subordinate Lien Bonds or Inferior Lien Bonds; and
- (9) Ninth, the balance shall be transferred to the Airports Improvement Fund.

**Senior Lien Bond Interest and Sinking Fund.** Except as may be otherwise provided in any ordinance authorizing any Senior Lien Obligations, so long as any Senior Lien Obligations remain Outstanding, after making all required payments and provision for payment of Operation and Maintenance Expenses, there shall be transferred to the Senior Lien Bond Interest and Sinking Fund from the Revenue Fund such amounts on such dates as may be provided in the ordinances authorizing the issuance of the Senior Lien Obligations in order to provide for the full and timely payment of all principal of, interest on and any redemption premiums on all such Senior Lien Obligations and all expenses of providing for their full and timely payment in accordance with their terms, including without limitation, all fees charged or incurred obligations in connection with bond insurance, letters of credit, lines of credit, standby bond purchase agreements, or other credit or liquidity facilities, remarketing agreements, interest rate indexing agreements and tender agent agreements obtained or entered into by the City in connection with any Senior Lien Obligations.

**Senior Lien Bond Reserve Fund.** So long as any Senior Lien Obligations secured by the Senior Lien Bond Reserve Fund remain Outstanding, the City shall establish and maintain a balance in the Senior Lien Bond Reserve Fund Participant Account of the Senior Lien Bond Reserve Fund equal to the Reserve Fund Requirement for the Senior Lien Bonds that are Reserve Fund Participants. The City shall establish and maintain a balance in the Senior Lien Note Reserve Fund Participant Account of the Senior Lien Bond Reserve Fund equal to the Reserve Fund Requirement for the Senior Lien Notes that are secured thereby. With respect to any series of Senior Lien Bonds that are not Reserve Fund



Participants, the City shall maintain a balance in the account created within the Senior Lien Bond Reserve Fund for such series equal to the Reserve Fund Requirement for such series of Senior Lien Bonds secured thereby.

Each increase in the Reserve Fund Requirement for any account of the Senior Lien Bond Reserve Fund resulting from the issuance of any Additional Senior Lien Obligations shall be satisfied at the time of issuance and delivery of such series of Additional Senior Lien Obligations. In any month in which any account of the Senior Lien Bond Reserve Fund contains less than the applicable Reserve Fund Requirement, then on or before the last Business Day of such month, after making all required payments and provision for payment of Operation and Maintenance Expenses, and after making all required transfers to the Senior Lien Bond Interest and Sinking Fund, there shall be transferred on a pro rata basis into the Senior Lien Bond Reserve Fund Participant Account (in the case of Senior Lien Bonds that are Reserve Fund Participants) and the Senior Lien Note Reserve Fund Participant Account (in the case of Senior Lien Notes that are Reserve Fund Participants) and such other designated accounts (in the case of Senior Lien Bonds that are not Reserve Fund Participants) of the Senior Lien Bond Reserve Fund from the Revenue Fund, such amounts as shall be required to permit the City to pay all reimbursement obligations under Senior Lien Bond Reserve Fund Surety Policies allocable to the various accounts of the Senior Lien Bond Reserve Fund, within a twelve (12) month period and such additional amounts as shall be sufficient to enable the City within a twelve (12) month period to reestablish in the various accounts of the Senior Lien Bond Reserve Fund, the applicable Reserve Fund Requirement for the Senior Lien Obligations secured thereby. After such amounts have been accumulated in the various accounts of the Senior Lien Bond Reserve Fund, and so long thereafter as such accounts contain such amounts, no further transfers shall be required to be made into the accounts of the Senior Lien Bond Reserve Fund. But if and whenever the balance in the accounts of the Senior Lien Bond Reserve Fund is reduced below such amount, monthly transfers to such account shall be resumed and continued in such amounts as shall be required to restore the balance in the accounts of the Senior Lien Bond Reserve Fund to such amount within a twelve (12) month period.

***Subordinate Lien Bond Interest and Sinking Fund.*** On or before the last Business Day of each month so long as any Subordinate Lien Bonds remain Outstanding, after making all required payments and provision for payment of Operation and Maintenance Expenses and making all required transfers to the Senior Lien Bond Interest and Sinking Fund and the Senior Lien Bond Reserve Fund, there shall be transferred into the Subordinate Lien Bond Interest and Sinking Fund from the Revenue Fund the following amounts:

- (i) Such amounts as shall be necessary so that the balance in the Subordinate Lien Bond Interest and Sinking Fund equals the Debt Service Requirements on all Subordinate Lien Bonds accrued to the end of the current month; plus
- (ii) Such amounts as shall be necessary to enable the City to pay when due all expenses of providing for the full and timely payment of the principal of, premium, if any, and interest on the Subordinate Lien Bonds in accordance with their terms, including without limitation, all fees charged or obligations incurred in connection with bond insurance, letters of credit, lines of credit, standby bond purchase agreements, or other credit or liquidity facilities, remarketing agreements, interest rate indexing agreements and tender agent agreements obtained or entered into by the City in connection with the Subordinate Lien Bonds.

Whenever the total amounts on deposit to the credit of the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund shall be equivalent to the sum of the aggregate principal amount of all Outstanding Subordinate Lien Bonds plus the aggregate amount of all interest accrued and to accrue thereon, no further transfers need be made into the Subordinate Lien Bond Interest and Sinking Fund or the Subordinate Lien Bond Reserve Fund, and such Subordinate Lien Bonds shall not be regarded as being Outstanding except for the purpose of being paid with the moneys credited to such Funds. Moneys credited to the Subordinate Lien Bond Interest and Sinking Fund shall be used solely for the purpose of paying principal (at maturity or prior redemption or to purchase Subordinate Lien Bonds issued as term bonds in the open market to be credited against mandatory redemption requirements), interest and redemption premiums on the Subordinate Lien Bonds, plus all bank charges and other costs and expenses relating to such payment, including those described in clause (ii) above. On or before each principal and/or interest payment date on the Subordinate Lien Bonds, the City shall transfer from the Subordinate Lien Bond Interest and Sinking Fund to the Paying Agent/Registrar for the Subordinate Lien Bonds an amount equal to the principal, interest and redemption premiums payable on the Subordinate Lien Bonds on such date including all amounts due and payable on Credit Agreements or Qualified Hedge Agreements relating to such Subordinate Lien Bonds.

***Subordinate Lien Bond Reserve Fund.*** The City shall establish and maintain a balance in the Subordinate Lien Bond Reserve Fund Participant Account of the Subordinate Lien Bond Reserve Fund equal to the Reserve Fund Requirement for the Subordinate Lien Bonds that are Reserve Fund Participants. With respect to any series of Subordinate Lien Bonds that are not Reserve Fund Participants, the City shall establish and maintain a balance in the accounts created within the Subordinate Lien Bond Reserve Fund for such series equal to the Reserve Fund Requirement for the Subordinate Lien Bonds that are secured thereby. Each increase in the Reserve Fund Requirement resulting from the issuance of any Additional Subordinate Lien Bonds shall be satisfied at the time of issuance and delivery of such series of Additional Subordinate Lien Bonds. The Reserve Fund Requirement shall be satisfied by depositing to the credit of the Subordinate Lien Bond Reserve Fund Participant Account (in the case of Additional Subordinate Lien Bonds that are Reserve Fund Participants) or such other designated accounts (in the case of Additional Subordinate Lien Bonds that are not Reserve Fund Participants) of the Subordinate Lien Bond Reserve Fund either (i) proceeds of such Additional Subordinate Lien Bonds or other lawfully appropriated funds in not less than the amount which, together with investment earnings thereon as estimated by the City, will be sufficient to fund fully the Reserve Fund Requirement by no later than the end of the period of time for which the payment of interest on such Additional Subordinate Lien Bonds has been provided out of proceeds of such Additional Subordinate Lien Bonds or investment earnings thereon as estimated by the City or from other lawfully available funds other than Net Revenues or (ii) a surety bond, insurance policy or letter of credit in a principal amount equal to the amount required to be funded, provided that, at the time of deposit, either the rating for the long-term unsecured debt of the issuer of such surety bond, insurance policy or letter of credit or the rating for obligations insured, secured or guaranteed by such issuer are required to be in one of the two highest letter categories by the at least one major municipal securities evaluation services (or, if such entities are no longer in existence, by comparable services) and which Subordinate Lien Bond Reserve Fund Surety Policy shall be payable on demand of the City for the benefit of the Owners of the Subordinate Lien Bonds that are secured thereby (collectively, a “Subordinate Lien Bond Reserve Fund Surety Policy”).

In any month in which any account of the Subordinate Lien Bond Reserve Fund contains less than the applicable Reserve Fund Requirement (or so much thereof as shall then be required to be therein if the City has elected to accumulate the Reserve Fund Requirement for any series of Additional Subordinate Lien Bonds as above provided), then on or before the last Business Day of such month, after making all required payments and provision for payment of Operation and Maintenance Expenses, and after making all required transfers to the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund and the Subordinate Lien Bond Interest and Sinking Fund, there shall be transferred on a pro rata basis into the Subordinate Lien Bond Reserve Fund Participant Account (in the case of Subordinate Lien Bonds that are Reserve Fund Participants) and such other designated accounts (in the case of Subordinate Lien Bonds that are not Reserve Fund Participants) of the Subordinate Lien Bond Reserve Fund from the Revenue Fund, amounts sufficient to enable the City to pay all reimbursement obligations under the Subordinate Lien Bond Reserve Fund Surety Policies within a twelve (12) month period and such additional amounts as shall be sufficient to enable the City within a twelve (12) month period to reestablish in the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, the Reserve Fund Requirement for the Subordinate Lien Bonds secured thereby. After such amounts have been accumulated in the Subordinate Lien Bond Reserve Fund Participant Account and such other designated accounts, and so long thereafter as such accounts contain such amounts, no further transfers shall be required to be made into the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, and any excess amounts in such accounts shall be transferred to the Subordinate Lien Bond Interest and Sinking Fund to the extent the excess is attributable to the Subordinate Lien Bond Reserve Fund for any tax-exempt Subordinate Lien Bonds, and otherwise shall be transferred to the Revenue Fund or such other Funds as may be permitted by federal tax law. But if and whenever the balance in the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts is reduced below such amount, monthly transfers to such accounts shall be resumed and continued in such amounts as shall be required to restore the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, to such amount within a twelve (12) month period. The Subordinate Lien Bond Reserve Fund Participant Account shall be used to pay the principal of and interest on the Subordinate Lien Bonds that are Reserve Fund Participants at any time when there is not sufficient money available in the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policies allocable to the Subordinate Lien Bond Reserve Fund Participant Account), to pay reimbursements under the Subordinate Lien Bond Reserve Surety Policies allocable to the Subordinate Lien Bond Reserve Fund Participant Account, and it may be used to make the final payments for the retirement or defeasance of all Subordinate Lien Bonds then Outstanding that are Reserve Fund Participants.

The City directs and requires the paying agent for any series of Subordinate Lien Bonds to ascertain the necessity for claim or draw upon the applicable Subordinate Lien Bond Reserve Fund Surety Policy and to provide notice to the

issuer thereof in accordance with its terms and to make such claims or draws thereon as may be necessary to provide for the timely payment of principal and interest on the Subordinate Lien Bonds to which it pertains.

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

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

***Airports Improvement Fund.*** Amounts credited to the Airports Improvement Fund may be used only for lawful Houston Airport System purposes, including without limitation, to pay for any capital expenditures or to pay costs of replacing any depreciable property or equipment of the Houston Airport System, to make any major or extraordinary repairs, replacements or renewals of the Houston Airport System, to acquire land or any interest therein, to pay any lease or contractual obligations not paid as Operation and Maintenance Expenses and to make any transfers required to cure any deficiencies in the Renewal and Replacement Fund; provided, however, that if at any time any unappropriated, unbudgeted, unreserved or otherwise unencumbered amounts in the Airports Improvement Fund exceeds (1) the unfunded amount of the Houston Airport System capital improvements program for the next 24 months or (2) \$50,000,000, whichever is greater, such excess amount may be used by the City for any lawful purpose not inconsistent with the terms of any Federal grants or aid or any contracts to which the City is a party.

***Deficiencies in Funds.*** If in any month there shall not be transferred into any Fund the full amounts required in the Ordinance, amounts equivalent to such deficiency shall be set apart and transferred to such Fund or Funds from the first available and unallocated moneys in the Revenue Fund, and such transfer shall be in addition to the amounts otherwise required to be transferred to such Funds during any succeeding month or months.

***Investment of Funds; Transfer of Investment Income.*** Money in the Revenue Fund, the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund, the Renewal and Replacement Fund and the Airports Improvement Fund shall, at the option of the City, be invested in time deposits or certificates of deposit secured in the manner required by law for public funds, or be invested in direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of America, in obligations of any agencies or instrumentalities of the United States of America or in any other investments authorized by Texas law; provided that all such deposits and investments shall be made in such manner that the money required to be expended from any Fund will be available at the proper time or times. All such investments shall be valued no less frequently than the last Business Day of the City's Fiscal Year at their market value, except that any direct obligations of the United States of America - State and Local Government Series shall be continuously valued at their par value or principal face amount. For purposes of maximizing investment returns, money in such Funds may be invested, together with money in other Funds or with other money of the City, in common investments of the kind described above, or in a common pool of such investments maintained by the City which shall be kept and held at an official depository of the City, which shall not be deemed to be a loss of the segregation of such money or Funds provided that safekeeping receipts, certificates of participation or other documents clearly evidencing the investment or investment pool in which such money is invested and the share thereof purchased with such money or owned by such Fund are held by or on behalf of each such Fund. If and to the extent necessary, such investments or participations therein shall be promptly sold to prevent any default.

All interest and income derived from deposits and investments credited to the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund and the Operation and Maintenance Reserve Fund, shall remain in such funds to the extent necessary to accumulate the Reserve Fund Requirements or other required balance therein. All interest and income derived from deposits and investments of any amounts held in any construction fund, including amounts held therein as capitalized interest, created by any ordinance authorizing the issuance of Senior Lien Obligations, Subordinate Lien Bonds or Inferior Lien Bonds, shall remain in such construction fund for application in the manner provided in such applicable ordinance.

To the extent it is not otherwise provided for above or specifically excluded from the definition of Gross Revenues, all interest and income derived from deposits and investments credited to the Revenue Fund, the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund, the Renewal and Replacement Fund and the Airports Improvement Fund, shall be transferred or credited monthly to the Revenue Fund or to such other Funds as may be required under federal tax law.

Notwithstanding anything to the contrary contained in the Ordinance, any interest and income derived from deposits and investments of any amounts credited to any fund or account may be paid to the federal government if in the opinion of nationally recognized bond counsel such payment is required in order to prevent interest on any Bonds from being includable within the gross income of the owners thereof for federal income tax purposes.

***Determination of Reserve Fund Participants.*** The Ordinance confirms that all Subordinate Lien Bonds Outstanding as of the date hereof are Reserve Fund Participants entitled to the benefit of the Subordinate Lien Bond Reserve Fund Participant Account of the Subordinate Lien Bond Reserve Fund.

#### **Annual Budget**

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

#### **Additional Senior Lien Obligations and Additional Subordinate Lien Bonds**

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

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

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

(3) The City Controller certifies that, for either the City's most recent complete Fiscal Year or for any consecutive 12 out of the most recent 18 months, the Net Revenues of the Houston Airport System were equal to at least (a)

125% of the Debt Service Requirements on all then-Outstanding Senior Lien Obligations for such period plus (b) 110% of the Debt Service Requirements on all then-Outstanding Subordinate Lien Bonds for such period;

(4) Either:

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

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

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

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

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

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

(9) The City may enter into Credit Agreements with respect to any Houston Airport System Bonds or Qualified Hedge Agreements if (a) prior to entering into such Credit Agreement, the City, to the extent required by law, shall cause the proceedings authorizing the Credit Agreement and any contracts or reimbursement agreements relating thereto to be submitted to and approved by the Attorney General of Texas; and (b) for any Credit Agreement that obligates the City to make any future payments for the availability of such Credit Agreement, the City's financial advisor for the

Houston Airport System must certify that the inclusion of such payments within the Debt Service Requirements on the Houston Airport System Bonds or Qualified Hedge Agreement to which the Credit Agreement relates will not cause such Houston Airport System Bonds or Qualified Hedge Agreement to fail to comply with the applicable coverage requirements for their issuance or incurrence. The issuer of any Credit Agreement shall be entitled to be subrogated to the rights of the Owners of the Houston Airport System Bonds or the counterparty to the Qualified Hedge Agreement secured by such Credit Agreement, and the City's reimbursement and repayment obligations to the issuer of the Credit Agreement shall be secured by Net Revenues as provided in the Ordinance; and

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

***Special Provisions for Short Term/Demand Obligations.*** In the Ordinance, the City has reserved the right to issue, from time to time, one or more series of Additional Senior Lien Bonds, Additional Senior Lien Notes, and/or Additional Subordinate Lien Bonds as Short Term/Demand Obligations, provided that the aggregate principal amount of Short Term/Demand Obligations Outstanding at any time may not exceed the greater of \$150,000,000 or 30% of the aggregate principal amount of Houston Airport System Bonds Outstanding at the time of issuance of the last series of Short Term/Demand Obligations, and further provided that the other conditions for issuing Additional Houston Airport System Bonds are met. In addition, no Short Term/Demand Obligation shall be subject to the limitations as to maximum principal amount as set forth above during any period of time that the City's financial advisor for the Houston Airport System certifies that the City's variable or adjustable interest rate exposure under such Short Term/Demand Obligation is substantially hedged pursuant to an interest rate swap, interest rate cap or other interest rate hedging mechanism with a counterparty having a rating in one of the two highest credit rating categories by at least two major rating agencies (or with a counterparty whose payment obligations under such interest rate swap, interest rate cap, or other interest rate hedging mechanism are insured or guaranteed by an entity having such rating) pursuant to which the maximum net rate of interest that the City is obligated to pay (after taking into account all payments to be made by such counterparty) does not exceed the interest rate certified with respect to such Short Term/Demand Obligation by such financial advisor pursuant to paragraph (ii) clause (2) of the definition of Debt Service Requirements.

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

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

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

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

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

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

### **Discharge by Deposit**

The City may discharge its obligation to the Owners of any or all of the Series 2012 Bonds or other series of Bonds to pay principal, interest and redemption premium (if any) thereon by depositing with the applicable paying agent/registrar cash in an amount equal to the principal amount and redemption premium, if any, of such Bonds plus interest thereon to the date of maturity or redemption, or by depositing either with the Paying Agent/Registrar or with any national banking association with capital and surplus in excess of \$100,000,000, pursuant to an escrow or trust agreement, cash and/or any obligation authorized under Texas law to be deposited for the payment or redemption of the such Bonds, in principal amounts and maturities and bearing interest at rates sufficient, based upon a verification report of an independent nationally recognized certified public accountant, to provide for the timely payment of the principal amount and redemption premium, if any, of such Bonds plus interest thereon to the date of maturity or redemption. Upon such deposit, such Bonds shall no longer be regarded as being Outstanding or unpaid. In case any Bonds are to be redeemed on any date prior to their maturity, the City shall give to the Paying Agent/Registrar instructions to give notice of redemption of said Bonds to be so redeemed in the manner required in the ordinance or ordinances authorizing such Bonds. For any Bonds not to be redeemed or paid in full within the next succeeding sixty (60) days from the date of deposit provided for in the Ordinance, the City shall give the paying agent/registrar, in form satisfactory to it, irrevocable instructions to mail, by certified mail, a notice to the Registered Owner of each such Bond that the required deposit has been made and that said Bonds are deemed paid in accordance with the Ordinance and stating such maturity or redemption date upon which moneys are to be available for the payment of the principal amount and redemption premium (if any) on such Bonds plus interest thereon to the date of maturity or redemption. Any failure, error or delay in giving such notice shall not affect the defeasance of such Bonds.

### **Certain Covenants and Agreements of the City**

***Maintenance of Airport System.*** The City covenants in the Ordinance that it will at all times maintain and operate the Airport System, or, within the limits of its authority, cause the same to be maintained and operated, in good and serviceable condition.

***Limitation on City Charges for Operation and Maintenance Expenses.*** The City covenants in the Ordinance that it will not charge the Airport System any amounts for overhead expenses relating to the administration, operation and maintenance of the Airport System except to the extent that such amounts are reasonably allocable to the Airport System based upon a stated policy of allocation, reasonably applied to the Airport System and all other departments of the City and further covenants that the City will not charge the Airport System for any property provided or services rendered by the City unless such services are reasonably necessary and required for the Airport System and are not otherwise provided to the Airport System. All such charges imposed by the City upon the Airport System shall be reasonable, fair and consistent with similar charges imposed upon other departments of the City and shall be consistent with all applicable federal laws, regulations and other requirements applicable to the Airport System or imposed upon the Airport System in connection with the acceptance by the Airport System of any federal grants or aid.

***Sale or Encumbrance of Airport System.*** Except for the use of the Airport System or services pertaining thereto in the normal course of business, neither all nor a substantial part of the Airport System shall be sold, leased, mortgaged, pledged, encumbered, alienated, or otherwise disposed of until all Senior Lien Obligations have been paid in full, or unless provision has been made therefor, and the City shall not dispose of its title to the Airport System or to any useful part thereof, including, without limitation, any property necessary to the operation and use of the Airport System, except for the execution of leases, licenses, easements, or other agreements in connection with the operation of the Airport System by the City, or in connection with any Special Facilities, except for any pledges of and liens on revenues derived from the operation and use of the Airport System, or any part thereof, or any Special Facilities pertaining thereto, for the payment of Senior Lien Obligations, Subordinate Lien Bonds, Special Facilities Bonds and any other obligations pertaining to the Airport System, and except as otherwise provided in the next two paragraphs.

The City may sell, exchange, lease, or otherwise dispose of, or exclude from the Airport System, any property constituting a part of the Airport System which the Aviation Director certifies (i) to be no longer useful in the construction or operation of the Airport System, or (ii) to be no longer necessary for the efficient operation of the Airport System, or (iii) to have been replaced by other property of at least equal value. The net proceeds of the sale or disposition of any Airport System property (or the fair market value of any property so excluded) pursuant to this paragraph shall be used for the purpose of replacing properties at the Airport System, or shall be paid into the Airports Improvement Fund for the purposes thereof.

Nothing herein shall prevent any transfer of all or a substantial part of the Airport System to another body corporate or politic (including, but not necessarily limited to a joint action agency or an airport authority) which assumes the City's obligations under the Ordinance and under any ordinance authorizing the issuance of Senior Lien Obligations or Subordinate Lien Bonds, wholly or in part, if, in the written opinion of the Airport Management Consultant, the ability to meet the rate covenant and other covenants under the Ordinance and under any ordinance authorizing the issuance of Senior Lien Obligations or Subordinate Lien Bonds, are not materially and adversely affected. In the event of any such transfer and assumption, nothing herein shall prevent the retention by the City of any facility of the Airport System if, in the written opinion of the Airport Management Consultant, such retention will not materially and adversely affect nor unreasonably restrict such other body's ability to comply with the requirements of the rate covenant and the other covenants of the Ordinance and in any ordinance authorizing the issuance of Senior Lien Obligations or Subordinate Lien Bonds.

***Insurance.*** The City covenants and agrees in the Ordinance that it will keep the Airport System insured with insurers of good standing against risks, accidents or casualties against which and to the extent customarily insured against by political subdivisions of the State of Texas operating similar properties, to the extent that such insurance is available. All net proceeds of such insurance shall be applied to repair or replace the insured property that is damaged or destroyed or to make other capital improvements to the Airport System or to redeem Senior Lien Obligations or Subordinate Lien Bonds, except for proceeds of business interruption insurance, which shall be credited to the Revenue Fund.

***Accounts, Records, and Audits.*** The City covenants and agrees that it will maintain a proper and complete system of records and accounts pertaining to the Gross Revenues and the operation of the Airport System in which full, true and proper entries will be made of all dealings, transactions, business and affairs which in any way affect or pertain to the Gross Revenues and the Airport System. The City shall, within 120 days after the close of each of its Fiscal Years or as soon thereafter as practicable, cause an audit report of such records and accounts to be prepared by an independent certified public accountant or independent firm of certified public accountants, which shall calculate the Gross Revenues, Net Revenues and Debt Service Requirements for such Fiscal Year and shall set forth a calculation to demonstrate whether the City has satisfied the rate covenant contained in the Ordinance. In addition, the City shall each year, as a part of its annual



audit, cause an independent certified public accountant or independent firm of certified public accountants to prepare a report containing an analysis of any overhead and direct charges imposed on the Airport System by the City to determine whether such charges were imposed in conformity with the covenant described above under “Limitation on City Charges for Operation and Maintenance Expenses.” Each year promptly after such reports are prepared, the City shall furnish copies thereof to any Owners of Senior Lien Obligations who shall request same. All expenses of obtaining such reports shall constitute Operation and Maintenance Expenses of the Airport System.

### **Amendments to Outstanding Ordinances**

In the Ordinance, the City ratifies and confirms any and all actions taken with respect to the amendment of each ordinance relating to the Outstanding Senior Lien Obligations and Subordinate Lien Bonds, in the ordinances authorizing the Series 2007 Bonds, the Series 2009 Bonds, and the Series 2010 Bonds (collectively, the “Amendments”). See Appendix B-2 for a full description of the Amendments.

The Amendments shall be effective and shall become incorporated into the ordinances authorizing the Outstanding Senior Lien Obligations and Outstanding Subordinate Lien Bonds on the Amendment Effective Date for the Amendments, which shall be set forth in the Officers Pricing Certificate. The City will certify that (i) the Amendments have been consented to by the required bond insurers and surety providers and (ii) notice has been given to the rating agencies, as required by the ordinances authorizing the Outstanding Subordinate Lien Bonds and the various agreements with the bond insurers. The City will not exercise its rights under the Amendments until such Amendment Effective Date.

### **Proposed Amendment to Outstanding Ordinances**

The City has determined that is in the best interest of the Airport System to amend the ordinances authorizing the issuance of all Senior Lien Obligations and Subordinate Lien Bonds as set forth in italics\* below (such amendment herein referred to as the “Proposed 2011 Amendment”):

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

The City intends to include the Proposed 2011 Amendment in each ordinance hereafter adopted authorizing any Additional Senior Lien Bonds, Additional Senior Lien Notes, or Additional Subordinate Lien Bonds and any series of Bonds issued to refund any Outstanding Bonds.

***Incorporation of the Proposed 2011 Amendment.*** The City will seek to achieve the incorporation of the Proposed 2011 Amendment as follows:

(a) the Proposed 2011 Amendment is adopted as part of the Ordinance, and shall be binding upon all Owners, from time to time, of the Series 2011 Bonds and the Series 2012 Bonds, and shall become effective on the Amendment Effective Date;

(b) the conditions for the effectiveness of the Proposed 2011 Amendment shall be deemed satisfied with respect to each series of Bonds upon either (x) payment in full or defeasance of such series of Bonds so that they are no longer Outstanding or (y) certification by the City that applicable ordinance authorizing such series of Bonds has been duly amended to incorporate the Proposed 2011 Amendment and that the conditions for amendment of such ordinance have been satisfied, as described below.

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\* From and after the Amendment Effective Date, the words “and “Ellington Airport” (formerly known as “Ellington Field”) are deleted from the definition of “Airport System.”

(c) the City authorizes each of its previously adopted ordinances pursuant to which Bonds are Outstanding to be amended to include the Proposed 2011 Amendment, subject, however, in each case to satisfying the conditions in such prior ordinances and in related documents which are required in order to amend the respective prior ordinances. Such conditions with respect to amending certain of the prior ordinances include the following (provided that such conditions are included for reference herein but are subject in all respects to the actual terms of the prior ordinances and related documents, as such terms may be amended or modified from time to time by the terms thereof): (1) with respect to each series of Outstanding Bonds, the City's certification that: (A) notice of the Proposed 2011 Amendment has been given as required by the ordinance authorizing the respective series of Bonds, including to the rating agencies; (B) in accordance with Section 9.03 of the ordinance authorizing such series of Bonds, the City has received the consent of either (i) the Owners of not less than a majority in aggregate unpaid amount of such bonds or (ii) the bond insurer (if any) as deemed owner of such Bonds; and (C) the ordinance authorizing each respective series of Bonds has been duly amended to incorporate the Proposed 2011 Amendment; and (2) to the extent applicable to any series of Outstanding Bonds, the City's certification that the City has received the consent of the provider of the reserve fund surety policy relating to such series or subseries of Bonds.

***Effective Date of Proposed Amendments.*** The Proposed 2011 Amendment shall become effective on the Amendment Effective Date for the Proposed 2011 Amendment. The Mayor, the City Attorney, the City's Director of Finance, the City Controller, and the Deputy City Controller are each authorized and directed to take any such actions and to prepare such notices, consents, certificates or other documentation as may be necessary to effectuate the amendment of the previously adopted ordinances pursuant to which Bonds are Outstanding. Further, the Mayor, the City Attorney, the City's Director of Finance, the City Controller, and the Deputy City Controller are each authorized and directed to execute and deliver, individually or together, one or more certificates or other documents as may be necessary or desirable in order to evidence the amendment of the prior ordinances authorizing Outstanding Bonds to incorporate the Proposed 2011 Amendment, or to evidence compliance with any prerequisites or conditions to the Amendment Effective Date. The occurrence of the Amendment Effective Date for the Proposed 2011 Amendment shall be evidenced by such certificate executed on behalf of and in the name of the City. The City shall not exercise its rights under the Proposed 2011 Amendment until the Amendment Effective Date.

The City may supplement, clarify, update, and otherwise amend the provisions of the Ordinance relating to amendments from time to time by ordinance as it deems necessary or appropriate. Counsel is authorized to prepare and obtain such notices and/or consents, if any, as may be required in connection therewith.

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## CERTAIN DEFINED TERMS

*Except as otherwise indicated, the following terms are defined in the Ordinance or otherwise used in the Official Statement. Proposed amendments are underlined and designated with an asterisk and will become effective from and after the Amendment Effective Date.*

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

“**Additional Senior Lien Bonds**” shall mean the additional senior lien revenue bonds and obligations permitted to be issued by the City pursuant to the Ordinance.

“**Additional Senior Lien Notes**” shall mean the additional senior lien revenue notes permitted to be issued by the City pursuant to the Ordinance.

“**Additional Senior Lien Obligations**” shall mean Additional Senior Lien Bonds and/or Additional Senior Lien Notes.

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

“**Airports Improvement Fund**” shall mean the fund described in Section 5.12 of the Ordinance.

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

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

“**Amendment Effective Date**” shall mean the date or dates on which any Amendment or Proposed Amendment (or portion thereof) is incorporated or deemed incorporated into every ordinance pursuant to which Bonds are Outstanding.

“**Authorized Denominations**” shall mean, with respect to the Series 2012 Bonds, \$5,000 or any integral multiple thereof, unless otherwise provided in the Officers Pricing Certificate.

“**Authorized Representative**” shall mean the person from time to time holding the office of the City Controller and, to the extent so designated in writing by the City Controller as set forth in the Ordinance, the Deputy Controller, or any officer or manager in the Debt Section of the Office of the City Controller.

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

“**Beneficial Owner**” means any Person that (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bond (including any Person holding a Bond through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bond for federal income tax purposes.

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\* From and after the Amendment Effective Date, the underlined text shall be replaced with the following: “George Bush Intercontinental Airport/Houston” and “William P. Hobby Airport.”

**“Bonds”** shall mean any or all of the Senior Lien Bonds, Senior Lien Notes, and the Subordinate Lien Bonds, as the context may indicate, including Completion Bonds and Short Term/Demand Obligations.

**“Bond Insurance Policy”** shall mean the municipal bond insurance policy or policies (if any) issued by the Bond Insurer that guarantees payment of the principal of and interest on any of the Series 2012 Bonds.

**“Bond Insurer”** shall mean the bond insurer(s), if any, identified in the Officers Pricing Certificate.

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

**“Completion Bonds”** shall mean each series of Additional Senior Lien Obligations or Additional Subordinate Lien Bonds issued to pay the cost of completing any project for which Senior Lien Obligations or Subordinate Lien Bonds, respectively, have previously been issued.

**“Comptroller”** shall mean the Comptroller of Public Accounts of the State of Texas.

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

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

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

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

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

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

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

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

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

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

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

**"DTC"** means The Depository Trust Company, New York, New York, or any successor thereto.

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

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

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

**“Form of Series 2012 Bond”** shall mean the form of bond approved in Article IV of the Ordinance and attached thereto as Exhibit A, with the final form of bond being approved by the Officers Pricing Certificate pursuant to Article III of the Ordinance and any supplement thereof.

**“Funds”** shall mean any fund or account established or maintained under the Ordinance.

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

- (i) proceeds of any Bonds and Inferior Lien Bonds;
- (ii) interest or other investment income derived from Bond proceeds deposited to the credit of any construction fund, or applied to fund capitalized interest, or interest or investment income required to be retained in the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund or any escrow fund in order to accumulate therein any amount or balance required to be accumulated or maintained therein pursuant to any ordinance authorizing any series of Bonds;
- (iii) any monies received as grants, appropriations, or gifts, the use of which is limited by the grantor or donor to the construction or acquisition of Airport System facilities, except to the extent any such monies shall be received as payments for the use of the Airport System facilities;
- (iv) any revenues derived from any Special Facilities which are pledged to the payment of Special Facilities Bonds;
- (v) insurance proceeds other than loss of use or business interruption insurance proceeds;
- (vi) the proceeds of any passenger facility charge or other per-passenger charge as may be hereafter authorized under federal law, including but not limited to, those revenues defined as PFC Revenues;
- (vii) sales and other taxes collected by the Airport System on behalf of the State of Texas and any other taxing entities;
- (viii) Federal Payments received by the Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes;
- (ix) the net proceeds received by the City from the disposition of any Airport System property;
- (x) any Excluded Fee and Charge Revenues; and
- (xi) any Taxable Bond Credit Revenues.

**“Inferior Lien Bonds”** shall mean each series of bonds, notes or other obligations permitted to be issued or incurred by the City pursuant to the Ordinance as Inferior Lien Bonds secured in whole or in part by liens on the Net Revenues that are junior and subordinate to the lien on Net Revenues securing payment of the Senior Lien Obligations and Subordinate Lien Bonds. Inferior Lien Bonds include but are not limited to the Series C Commercial Paper Obligations.

**“Interest Payment Date”** with respect to the Series 2012 Bonds shall mean the date(s) designated as such in the Form of Series 2012 Bond and/or the Officers Pricing Certificate.

**“Issuance Date”** with respect to each series of the Series 2012 Bonds issued under the Ordinance, shall mean the date of initial delivery for each such series of Series 2012 Bonds to the Underwriter, as further designated in the applicable Officers Pricing Certificate. If more than one series of Series 2012 Bonds is issued under the Ordinance, the separate series of Series 2012 Bonds may have separate delivery dates.

**“Maximum Lawful Rate”** means the maximum rate of interest allowed by Chapter 1204, Texas Government Code, as amended.

**“Net Revenues”** shall mean that portion of the Gross Revenues remaining after the deduction of the Operation and Maintenance Expenses.

**“Non-PAB Bond”** shall mean any Series 2012 Bond that is to be designated by the City in the Officers Pricing Certificate as “Non-PAB” or as a “non-private activity bond.”

**“Non-PAB Refunded Bond”** shall mean any Refunded Obligation that is refunded with proceeds of a Non-PAB Bond.

**“Officers Pricing Certificate(s)”** shall mean one or more certificates executed by either the Mayor or the City’s Director of Finance and the City Controller or the Deputy City Controller with respect to the pricing of any series of Series 2012 Bonds pursuant to the Ordinance.

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

- (a) any allowance for depreciation;
- (b) costs of capital improvements;
- (c) reserves for major capital improvements, Airport System operations, maintenance or repair;
- (d) any allowance for redemption of, or payment of interest or premium on, Bonds;
- (e) any liabilities incurred in acquiring or improving properties of the Airport System;
- (f) expenses of lessees under Special Facilities Leases and operation and maintenance expenses pertaining to Special Facilities Leases to the extent they are required to be paid by such lessees pursuant to the terms of the Special Facilities Leases;

- (g) any charges or obligations incurred in connection with any lawful Airport System purpose, including the lease, acquisition, operation or maintenance of any facility or property benefiting the Airport System, provided that the payment of such charges or obligations is expressly agreed by the payee to be payable solely from proceeds of the Airports Improvement Fund;
- (h) liabilities based upon the City's negligence or other grounds not based on contract; and
- (i) so long as Federal Payments are excluded from Gross Revenues, an amount of expenses that would otherwise constitute Operation and Maintenance Expenses for such period equal to the Federal Payments for such period.

Operation and Maintenance Expenses shall only include those current expenses due or payable within the next 30 days.

**“Ordinance”** shall mean the bond ordinance, the exhibits attached thereto and all amendments and supplements relating to such bond ordinance, including any findings or determinations made in the Officers Pricing Certificate.

**“Outstanding”** when used with reference to the Senior Lien Bonds, Senior Lien Notes or Subordinate Lien Bonds, as the case may be, means, as of a particular date, all such bonds or notes theretofore and thereupon delivered except: (a) any such bond or note cancelled by or on behalf of the City at or before said date; (b) any such bond or note defeased pursuant to the defeasance provisions of the ordinance authorizing its issuance, or otherwise defeased as permitted by applicable law; and (c) any such bond or notes in lieu of or in substitution for which another bond shall have been delivered pursuant to the ordinance authorizing the issuance of such bond or note.

**“Owner”** or **“Registered Owner”**, when used with respect to any Senior Lien Bond, Senior Lien Note or Subordinate Lien Bond shall mean the person or entity in whose name such bond or note is registered in the Register. Any reference to a particular percentage or proportion of the Owners shall mean the Owners at a particular time of the specified percentage or proportion in aggregate principal amount of all Senior Lien Bonds, Senior Lien Notes or Subordinate Lien Bonds then Outstanding under the Ordinance.

**“PAB Bond”** shall mean any Series 2012 Bond that is to be designated by the City in the Officers Pricing Certificate as a “PAB” or a “private activity bond.”

**“PAB Refunded Bond”** shall mean any Refunded Obligation that is refunded with proceeds of a PAB Bond.

**“Participant”** means, with respect to DTC or another Securities Depository, a member of or participant in DTC or such other Securities Depository, respectively.

**“Paying Agent/Registrar”** shall mean, for the Series 2012 Bonds, initially The Bank of New York Mellon Trust Company, National Association, and its successors in that capacity.

**“PFC Revenues”** shall mean, during any Fiscal Year, proceeds of any charges and fees collected by the Airport System, including passenger facility charges collected by the City pursuant to the authority granted by the Aviation Safety and Capacity Expansion Act of 1990 and 14 CFR Part 158, as amended from time to time, in respect to any component of the Airport System, and interest earnings thereon.

**“Principal Office”** means, with respect to the Paying Agent/Registrar, the address identified as its notice address in the Paying Agent/Registrar Agreement or otherwise notified in writing by the Paying Agent/Registrar to the City.

**“Qualified Hedge Agreement”** shall mean any agreement between the City and a qualifying financial institution (as described in the following sentence) for the purpose of providing an interest rate swap, exchange, cap, collar, floor, forward or other hedging mechanism, arrangement or security, however denominated, expressly identified pursuant to its terms as being entered into in connection with and in order to hedge interest rate fluctuations on any portion of any Airport System Bonds and in consideration for which the City may agree to pay, but solely from Net Revenues as herein provided, (i) periodic payments for the availability of such Qualified Hedge Agreement and/or (ii) net amounts as a result of fluctuation in hedged interest rates or in the value of any index of payment and/or (iii) termination charges. A Qualified



Hedge Agreement may only be entered into with a financial institution that has long-term credit ratings or the obligations of which are unconditionally guaranteed by a financial institution with long-term credit ratings in one of the two highest generic rating categories by two of the nationally recognized rating services then rating the Bonds. Obligations of the City pursuant to a Qualified Hedge Agreement shall be included within the definition of Debt Service Requirements for the series of Bonds to which the Qualified Hedge Agreement relates. Further, obligations of the City to make payments under a Qualified Hedge Agreement derived from or resulting from a fluctuation in hedged interest rates or in the value of any index of payment shall be deemed to be payments of interest on the Bonds so hedged. Each Qualified Hedge Agreement shall be deemed to be a part of the Bonds of the series to which it relates for the purpose of securing its payment by the pledge of Net Revenues as provided in the Ordinance. However, issuers of and counterparties to Qualified Hedge Agreements shall not be treated as Owners of Bonds for purposes of any voting rights to approve amendments or direct the exercise of any remedies under the Ordinance.

**“Refunded Bonds”** shall mean all or any such portion of the Outstanding Bonds as may be designated in the applicable Officers Pricing Certificate to be refunded with proceeds of the Series 2012 Bonds.

**“Refunded Bonds Escrow Agent”** shall mean The Bank of New York Mellon Trust Company, National Association, and its successors in such capacity, or such other escrow agent(s) designated in the Officers Pricing Certificate or supplemental ordinance.

**“Refunded Bonds Escrow Agreement”** shall mean one or more escrow agreements between the City and the Refunded Bonds Escrow Agent related to the Refunded Bonds, in substantially the form approved by the Officers Pricing Certificate.

**“Refunded Bonds Escrow Fund”** shall mean one or more special dedicated escrow funds created under the Refunded Bonds Escrow Agreement and maintained by the Escrow Agent for the benefit of the holders of the Refunded Bonds

**“Register”** shall mean the books of registration kept by the Paying Agent/Registrar in which are maintained the name and address of, and the principal amounts registered to, each Owner.

**“Regulations”** shall have the meaning assigned to that term in Section 11.01 of the Ordinance.

**“Renewal and Replacement Fund”** shall mean the fund described in Section 5.11 of the Ordinance.

**“Reserve Fund Participants”** shall mean: (i) with respect to Senior Lien Bonds, any series of Senior Lien Bonds designated by the City as “Reserve Fund Participants” and secured by a lien on the Senior Lien Bond Reserve Fund Participant Account of the Senior Lien Bond Reserve Fund, and (ii) with respect to Senior Lien Notes, the Series A Commercial Paper Notes, the Series B Commercial Paper Notes, and any other series of Senior Lien Notes secured by a lien on the Senior Lien Note Reserve Fund Participant Account of the Senior Lien Bond Reserve Fund, and (iii) with respect to the Subordinate Lien Bonds, any series of Subordinate Lien Bonds designated by the City as “Reserve Fund Participants” and secured by a lien on the Subordinate Lien Bond Reserve Fund Participant Account of the Subordinate Lien Bond Reserve Fund.

**“Reserve Fund Requirement”** shall mean the amount required to be maintained in the Senior Lien Bond Reserve Fund (and the accounts therein) or the Subordinate Lien Bond Reserve Fund (and the accounts therein), as the case may be, as further set forth in the applicable ordinance and/or officers pricing certificate authorizing one or more series of Bonds. For Senior Lien Bonds, such amount shall be the amount required in the ordinances authorizing the Senior Lien Bonds. For Subordinate Lien Bonds that are Reserve Fund Participants, such amount shall be computed and recomputed upon the issuance of each series of Subordinate Lien Bonds that are Reserve Fund Participants and on each date on which Subordinate Lien Bonds that are Reserve Fund Participants are paid at maturity or optionally or mandatorily redeemed, to be the greatest amount of the Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for all Subordinate Lien Bonds then Outstanding that are Reserve Fund Participants, including any series of Subordinate Lien Bonds then being issued that are Reserve Fund Participants. For any series of Subordinate Lien Bonds that are not Reserve Fund Participants, such amount shall be computed upon the issuance of such series of Subordinate Lien Bonds and on each date on which any of such series of Subordinate Lien Bonds are paid at maturity or optionally or mandatorily

redeemed, to be the greatest amount of the Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for such series of Subordinate Lien Bonds then Outstanding. Upon the issuance of any series of Additional Subordinate Lien Bonds, the Reserve Fund Requirement for the Subordinate Lien Bonds shall be as set forth in the Officers' Pricing Certificate. Notwithstanding the foregoing, the amount of the Reserve Fund Requirement properly allocable to each issue of Bonds, whether or not such issue is a Reserve Fund Participant, shall at no time exceed, the lesser of (a) the maximum annual debt service on such issue of Bonds, (b) one hundred twenty-five percent (125%) of the average annual debt service on such issue of Bonds or (c) ten percent (10%) of the initial principal amount of such issue of Bonds (or sale proceeds in the event that the amount of original issue discount exceeds two percent (2%) multiplied by the stated redemption price at maturity of such issue of Bonds), all within the meaning of Section 1.148-2(f)(2)(ii) of the Regulations.

**"Securities Act"** means the Securities Act of 1933, as amended.

**"Senior Lien Bond Interest and Sinking Fund"** shall mean the fund so designated that was created and established pursuant to the ordinances authorizing the Senior Lien Obligations and that is maintained pursuant to the Ordinance.

**"Senior Lien Bond Reserve Fund"** shall mean the fund so designated that was created and established pursuant to the ordinances authorizing the Senior Lien Obligations, including the accounts established therein, and that is maintained pursuant to the Ordinance.

**"Senior Lien Bonds"** shall mean the Outstanding Series 2009 Bonds and each series of Additional Senior Lien Bonds from time to time hereafter issued.

**"Senior Lien Notes"** shall mean the Outstanding Series A and B Commercial Paper Obligations and any Additional Senior Lien Notes from time to time hereafter issued.

**"Senior Lien Obligations"** shall mean either or both of the Senior Lien Bonds and the Senior Lien Notes, as applicable.

**"Series 1997A Special Facilities Bonds"** shall mean the City of Houston, Texas, Airport System Special Facilities Revenue Bonds (Automated People Mover Project), Series 1997A.

**"Series 1998 Bonds"** shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds, Series 1998B (AMT) and Series 1998C (Non-AMT).

**"Series 2000 Bonds"** shall collectively mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds Series 2000A (AMT) and Series 2000B (Non-AMT) and Subordinate Lien Revenue Bonds (Periodic Auction Reset Securities), Series 2000P-1 (AMT) and P-2 (AMT).

**"Series 2001 Bonds"** shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Refunding Bonds, Series 2001A (AMT).

**"Series 2002 Bonds"** shall collectively mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Bonds Series 2002A (AMT), the Series 2002B (Non-AMT), the Series 2002C (AMT) (Auction Rate Securities), the Series 2002D-1 (AMT) (Auction Rate Securities), and the Series 2002D-2 (AMT) (Auction Rate Securities).

**"Series 2007B Bonds"** shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Refunding Bonds, Series 2007B (Non-AMT).

**"Series 2009 Bonds"** shall mean the City of Houston, Texas, Airport System Senior Lien Revenue and Refunding Bonds, Series 2009A (Non-AMT).

**"Series 2010 Bonds"** shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Refunding Bonds, Series 2010 (Non-AMT).

**“Series 2011 Bonds”** shall mean the City of Houston, Texas, Airport System Subordinate Lien Revenue Refunding Bonds, Series 2011A (AMT) and Series 2011B (Non-AMT).

**“Series 2012 Bonds”** shall mean the bonds authorized pursuant to the Ordinance and the Officers Pricing Certificate as contemplated by the Ordinance.

**“Series A and B Commercial Paper Obligations”** shall mean the Series A Commercial Paper Notes and the Series B Commercial Paper Notes and credit agreements related thereto.

**“Series A Commercial Paper Notes”** shall mean the City of Houston, Texas, Airport System Senior Lien Commercial Paper Notes, Series A (AMT).

**“Series B Commercial Paper Notes”** shall mean the City of Houston, Texas, Airport System Senior Lien Commercial Paper Notes, Series B (Non-AMT).

**“Series C Commercial Paper Obligations”** shall mean the City of Houston, Texas Airport System Inferior Lien Commercial Paper Notes, Series C and any credit agreements related thereto.

**“Short Term/Demand Obligations”** shall mean each series of bonds, notes and other obligations issued in accordance with the Ordinance, (a) the payment of principal of which is either (i) payable on demand by or at the option of the holder at a time sooner than a date on which such principal is deemed to be payable for purposes of computing Debt Service Requirements, or (ii) scheduled to be payable within one year from the date of issuance and is contemplated to be refinanced for a specified period or term through the issuance of additional Short Term/Demand Obligations pursuant to a commercial paper or other similar financing program, and (b) the purchase price, payment or refinancing of which is additionally secured by a letter of credit, line of credit, standby bond purchase agreement, bond insurance, surety bond or other credit or liquidity facility which does not impose upon the City a reimbursement obligation payable over a period shorter than three years.

**“Special Facilities”** shall mean structures, hangars, aircraft overhaul, maintenance or repair shops, heliports, hotels, storage facilities, garages, in-flight kitchens, training facilities, consolidated rental car facilities, terminal facilities, cargo facilities and any and all other facilities and appurtenances being a part of or related to the Airport System, the cost of the construction or other acquisition of which is financed with the proceeds of Special Facilities Bonds.

**“Special Facilities Bonds”** shall mean any bonds heretofore or from time to time hereafter issued by the City pursuant the Ordinance, including, but not limited to, the Series 1997A Special Facilities Bonds.

**“Special Facilities Lease”** shall mean any lease or agreement, howsoever denominated, pursuant to which a Special Facilities are leased by the City to the lessee in consideration for which the lessee agrees to pay (i) all debt service on the Special Facilities Bonds issued to finance the Special Facilities (which payments are pledged to secure the Special Facilities Bonds) and (ii) the operation and maintenance expenses of the Special Facilities.

**“Subordinate Lien Bond Interest and Sinking Fund”** shall mean the fund so designated that is required to be maintained pursuant to the Ordinance.

**“Subordinate Lien Bond Reserve Fund”** shall mean the fund so designated that was created and established pursuant to the ordinances authorizing the Subordinate Lien Bonds, including the accounts established therein, and that is required to be maintained pursuant to the Ordinance.

**“Subordinate Lien Bond Reserve Fund Participant Account”** shall mean the account within the Subordinate Lien Bond Reserve Fund, which account shall constitute trust funds and shall be held in trust for Owners of the Subordinate Lien Bonds that are Reserve Fund Participants.

**“Subordinate Lien Bond Reserve Fund Surety Policy”** shall mean any surety bonds, insurance policies, letters of credit or other instruments as provided in any ordinance authorizing the issuance of any Subordinate Lien Bonds,

whether heretofore or hereafter acquired for the purpose of satisfying all or any part of the Reserve Fund Requirement for the Subordinate Lien Bonds.

**“Subordinate Lien Bonds”** shall mean the Outstanding Series 1998 Bonds, Series 2000 Bonds, Series 2001 Bonds, Series 2002 Bonds, Series 2007B Bonds, Series 2010 Bonds, the Series 2011 Bonds, the Series 2012 Bonds and each series of Additional Subordinate Lien Bonds which the City has reserved the right to issue from time to time, payable from and secured by a lien on and pledge of Net Revenues junior and subordinate to the lien and pledge securing the Senior Lien Obligations

**“Taxable Bond”** shall mean any Series 2012 Bond that is not a Tax-Exempt Bond.

**“Taxable Bond Credit Revenues”** shall mean payments (i) made to the City from the federal government or any agency or department thereof with respect to the return to the City of a portion of the interest paid by the City on any taxable Bonds, including but not limited to any such payments received pursuant to the American Recovery and Reinvestment Act of 2009 or any legislation in amendment or succession thereto and (ii) received by the City after the Amendment Effective Date.

**“Tax-Exempt Bond”** shall mean a PAB Bond or a Non-PAB Bond.

**“2012 Subordinate Lien Reserve Fund Surety Policy”** shall mean the debt service reserve fund policy or policies, if any, authorized pursuant to the Ordinance and issued in the amounts and by the provider(s) identified in the applicable Officers Pricing Certificate.

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## APPENDIX B-2

### DESCRIPTION OF AMENDMENTS

*The Amendments to the ordinances authorizing the issuance of the Outstanding Houston Airport System Bonds are shown in bold italics herein. Refer to the following City of Houston ordinances for further information regarding the Amendments: (i) Ordinance No. 2007-287 (2007 Amendments), (ii) Ordinance No. 2009-600 (2009 Amendments), (iii) Ordinance No. 2010-893 (2010 Amendments).*

#### 2007 Amendments

1. The definition of “**Debt Service Requirements**” is amended to read in its entirety as follows:

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

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

plus

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

less

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

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

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

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

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

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

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

2. The definition of "**Gross Revenues**" is amended to read in its entirety as follows:

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

(i) proceeds of any Bonds and Inferior Lien Bonds;

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

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

- (iv) any revenues derived from any Special Facilities which are pledged to the payment of Special Facilities Bonds;
- (v) insurance proceeds other than loss of use or business interruption insurance proceeds;
- (vi) the proceeds of any passenger facility charge or other per-passenger charge as may be hereafter authorized under federal law including, but not limited to, those revenues defined as PFC Revenues;
- (vii) sales and other taxes collected by the Airport System on behalf of the State of Texas and any other taxing entities;
- (viii) Federal Payments received by the Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes;
- (ix) the net proceeds received by the City from the disposition of any Airport System property; and
- (x) *any Excluded Fee and Charge Revenues.*

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## 2009 Amendments

1. The definition of “**Gross Revenues**” is amended to read in its entirety as follows:

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

- (i) proceeds of any Bonds and Inferior Lien Bonds;
- (ii) interest or other investment income derived from Bond proceeds deposited to the credit of any construction fund, or applied to fund capitalized interest, or interest or investment income required to be retained in the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Reserve Fund, the Operation and Maintenance Reserve Fund or any escrow fund in order to accumulate therein any amount or balance required to be accumulated or maintained therein pursuant to any ordinance authorizing any series of Bonds;
- (iii) any monies received as grants, appropriations, or gifts, the use of which is limited by the grantor or donor to the construction or acquisition of Airport System facilities, except to the extent any such monies shall be received as payments for the use of the Airport System facilities;
- (iv) any revenues derived from any Special Facilities which are pledged to the payment of Special Facilities Bonds;
- (v) insurance proceeds other than loss of use or business interruption insurance proceeds;
- (vi) the proceeds of any passenger facility charge or other per-passenger charge as may be hereafter authorized under federal law including, but not limited to, those revenues defined as PFC Revenues;
- (vii) sales and other taxes collected by the Airport System on behalf of the State of Texas and any other taxing entities;
- (viii) Federal Payments received by the Airport System unless the City first receives an opinion from nationally recognized bond counsel to the effect that such payments, if included in Gross Revenues, would not cause the interest on the Bonds to be includable within the gross income of the Owners thereof for federal income tax purposes;
- (ix) the net proceeds received by the City from the disposition of any Airport System property;
- (x) any Excluded Fee and Charge Revenues; and
- (xi) *any Taxable Bond Credit Revenues.*



## 2010 Amendments

The following definitions shall be added, as applicable, or shall amend and restate the existing definition of such terms in their entirety:

**“Reserve Fund Participants”** shall mean (i) with respect to Senior Lien Bonds, any series of Senior Lien Bonds designated by the City as “Reserve Fund Participants” and secured by a lien on the Senior Lien Bond Reserve Account of the Senior Lien Bond Reserve Fund, (ii) with respect to Senior Lien Notes, the Series A Commercial Paper Notes, the Series B Commercial Paper Notes, and any other series of Senior Lien Notes secured by a lien on the Senior Lien Note Reserve Account of the Senior Lien Bond Reserve Fund, and *(iii) any series of Subordinate Lien Bonds designated by the City as “Reserve Fund Participants” and secured by a lien on the Subordinate Lien Bond Reserve Fund Participant Account of the Subordinate Lien Bond Reserve Fund.*

**“Reserve Fund Requirement”** shall mean the amount required to be maintained in the Senior Lien Bond Reserve Fund (and the accounts therein) or the Subordinate Lien Bond Reserve Fund (and the accounts therein), as the case may be, as further set forth in the applicable ordinance and/or officers pricing certificate authorizing a series of Bonds. *For Senior Lien Bonds, such amount shall be the amount required in the ordinances authorizing the Senior Lien Bonds. For Subordinate Lien Bonds that are Reserve Fund Participants, such amount shall be computed and recomputed upon the issuance of each series of Subordinate Lien Bonds that are Reserve Fund Participants and on each date on which Subordinate Lien Bonds that are Reserve Fund Participants are paid at maturity or optionally or mandatorily redeemed, to be the greatest amount of the Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for all Subordinate Lien Bonds then Outstanding that are Reserve Fund Participants, including any series of Subordinate Lien Bonds then being issued that are Reserve Fund Participants. For any series of Subordinate Lien Bonds that are not Reserve Fund Participants, such amount shall be computed upon the issuance of such series of Subordinate Lien Bonds and on each date on which any of such series of Subordinate Lien Bonds are paid at maturity or optionally or mandatorily redeemed, to be the greatest amount of the Debt Service Requirements scheduled to occur in the then current and each future Fiscal Year for such series of Subordinate Lien Bonds then Outstanding. Upon the issuance of any series of Additional Subordinate Lien Bonds, the Reserve Fund Requirement for the Subordinate Lien Bonds shall be as set forth in the Officers Pricing Certificate. Notwithstanding the foregoing, the amount of the Reserve Fund Requirement properly allocable to each issue of Bonds, whether or not such issue is a Reserve Fund Participant, shall at no time exceed, the lesser of (a) the maximum annual debt service on such issue of Bonds, (b) one hundred twenty-five percent (125%) of the average annual debt service on such issue of Bonds or (c) ten percent (10%) of the initial principal amount of such issue of Bonds (or sale proceeds in the event that the amount of original issue discount exceeds two percent multiplied by the stated redemption price at maturity of such issue of Bonds), all within the meaning of Section 1.148-2(f)(2)(ii) of the Regulations.*

**“Subordinate Lien Bond Reserve Fund”** shall mean the fund so designated *which was created and established pursuant to the ordinances authorizing the Subordinate Lien Bonds, including the accounts established therein, and* which is required to be maintained pursuant to Section 5.09 of this Ordinance.

**“Subordinate Lien Bond Reserve Fund Participant Account”** *shall mean the account of such name created under Section 5.04 within the Subordinate Lien Bond Reserve Fund.*

**Subordinate Lien Bond Reserve Fund Surety Policy** shall mean any one or more of the instruments so defined in Section 5.09 hereof, whether heretofore or hereafter acquired *which, at the time of deposit, is rated as set forth in Section 5.09 and is* for the purpose of satisfying all or any part of the *applicable* Reserve Fund Requirement for any Subordinate Lien Bonds.

The 2010 Amendments amend and restate Article V in its entirety. For purposes of this summary, shown below are excerpts of the 2010 Amendments to Article V that show the sections that are being changed by the 2010 Amendments.

## ARTICLE V

### SECURITY AND SOURCE OF PAYMENT FOR ALL BONDS

SECTION 5.01 PLEDGE AND SOURCE OF PAYMENT. The City hereby covenants and agrees that all Gross Revenues shall be deposited and paid into the special funds hereinafter established, and shall be applied in the manner hereinafter set forth, in order to provide for the payment of all Operation and Maintenance Expenses of the Airport System and all principal, interest and any redemption premiums on the Senior Lien Obligations and the Subordinate Lien Bonds and all expenses of providing for their full and timely payment in accordance with their terms. The Subordinate Lien Bonds shall constitute special obligations of the City that shall be payable from, and subject to the prior and superior lien of the Senior Lien Obligations, shall be equally and ratably secured by a lien on, the Net Revenues. Such Net Revenues, together with certain proceeds of the Subordinate Lien Bonds or other lawfully available funds of the City, shall, in the manner herein provided, be set aside for and pledged to the payment of the Subordinate Lien Bonds in the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund as hereinafter provided. For the benefit of the Owners of the Subordinate Lien Bonds, the City hereby grants a lien on the Net Revenues (subject to the prior and superior lien of the Senior Lien Obligations) and further grants a lien on the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund to secure the payment of principal of, redemption premium, if any, and interest on the Subordinate Lien Bonds and all expenses of providing for their full and timely payment in accordance with their terms. For the additional benefit of Owners of the Subordinate Lien Bonds that are Reserve Fund Participants, the City hereby grants a lien on the Subordinate Lien Bond Reserve Fund Participant Account of the Subordinate Lien Bond Reserve Fund. ***For the additional benefit of the Owners of any one or more series of Subordinate Lien Bonds that are not Reserve Fund Participants, the City may create one or more separate accounts within the Subordinate Lien Reserve Fund and grant a lien on such account(s) for the benefit of the Owners of such series of Subordinate Lien Bonds that are not Reserve Fund Participants. Except with respect to the separate accounts of the Subordinate Lien Bond Reserve Fund described in this Section, all Subordinate Lien Bonds shall be in all respects on a parity with and of equal dignity with one another. The Owners of the Subordinate Lien Bonds shall never have the right to demand payment of either the principal of, interest on or any redemption premium on the Subordinate Lien Bonds out of any funds raised or to be raised by taxation. Pursuant to Chapter 1208, Texas Government Code, the lien on Net Revenues created hereunder is valid, effective, and perfected.***

***SECTION 5.01A PLEDGE AND SOURCE OF PAYMENT WITH RESPECT TO BANK BONDS.\*\* To provide security for the payment of the principal and interest when due on Bank Bonds purchased by the Credit Facility Provider or the Liquidity Facility Provider pursuant to the Credit Facility or Liquidity Facility with respect to the [INSERT NAME OF SERIES], the City hereby grants a lien on and pledge of the following, subject to the provisions of this Ordinance permitting the application thereof for the purposes and on the terms and conditions set forth herein:***

- (i) the Net Revenues (subject to the prior and superior lien of the Senior Lien Obligations);***
- (ii) the Subordinate Lien Bond Interest and Sinking Fund; and***
- (iii) the account of the Subordinate Lien Bond Reserve Fund securing the [INSERT NAME OF SERIES].***

***Provided however, that the lien and pledge provided in this Section 5.01A with respect to the Bank Bonds shall be in all respects on a parity with and of equal dignity with the lien and pledge of such revenues and funds with respect to all Subordinate Lien Bonds. The Credit Facility Provider and the Liquidity Facility Provider shall never have the right to demand payment of either the principal of or interest on Bank Bonds out of any funds raised or to be raised by taxation.***

SECTION 5.02 No Amendments Proposed.

SECTION 5.03 No Amendments Proposed.

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***\*\*This section may be included in the ordinance for any Subordinate Lien Bonds authorizing a Credit Facility or Liquidity Facility with respect to such Subordinate Lien Bonds, and may be adjusted as appropriate to reflect the terms of such facilities.***

SECTION 5.04 SPECIAL FUNDS. (a) The following special funds shall be established, maintained and accounted for as hereinafter provided so long as any of the Senior Lien Obligations remain Outstanding:

- (i) Revenue Fund;
- (ii) Senior Lien Bond Interest and Sinking Fund;
- (iii) Senior Lien Bond Reserve Fund;
- (iv) Subordinate Lien Bond Interest and Sinking Fund;
- (v) Subordinate Lien Bond Reserve Fund;
- (vi) Operation and Maintenance Reserve Fund;
- (vii) Renewal and Replacement Fund; and
- (viii) Airports Improvement Fund.

(b) The Revenue Fund, the Operation and Maintenance Reserve Fund, the Renewal and Replacement Fund and the Airports Improvement Fund shall be maintained as separate funds or accounts on the books of the City and all amounts credited to such Funds shall be maintained in an official depository bank of the City or in a trustee bank designated by the City. The Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund, the Subordinate Lien Bond Interest and Sinking Fund and the Subordinate Lien Bond Reserve Fund shall be maintained at an official depository bank of the City or in a trustee bank designated by the City separate and apart from all other funds and accounts of the City.

The Senior Lien Bond Interest and Sinking Fund shall constitute trust funds which shall be held in trust for the Owners of the Senior Lien Obligations to which they are pledged, and the proceeds of which (other than the interest income thereon, which may be transferred to the Revenue Fund or such other Funds as may be required under federal tax law) shall be pledged to the payment of the Senior Lien Obligations. The Senior Lien Bond Reserve Fund and the accounts created therein are pledged to the particular Senior Lien Obligations as described herein and in the ordinances authorizing the issuance of the Senior Lien Obligations. Within the Senior Lien Bond Reserve Fund, there has been created a Senior Lien Bond Reserve Account and a Senior Lien Note Reserve Account. The Senior Lien Bond Reserve Account shall constitute trust funds which shall be held in trust for the Owners of the Senior Lien Bonds to which they are pledged. The proceeds of the Senior Lien Bond Reserve Account (other than the interest income thereon, which may be transferred to the Senior Lien Bond Interest and Sinking Fund) shall be pledged to the payment of the Senior Lien Bonds that are Reserve Fund Participants. The Senior Lien Note Reserve Account shall constitute trust funds which shall be held in trust for the Owners of the Senior Lien Notes to which they are pledged. The proceeds of the Senior Lien Note Reserve Account (other than the interest income thereon, which may be transferred to the Senior Lien Bond Interest and Sinking Fund) shall be pledged to the payment of the Senior Lien Notes. The City reserves the right to issue Additional Senior Lien Bonds which are not Reserve Fund Participants and are not secured by the Senior Lien Bond Reserve Account; provided that the City may create a separate account within the Senior Lien Bond Reserve Fund for the benefit of any such series that is not a Reserve Fund Participant, the proceeds of which account (other than the interest income thereon, which may be transferred to the Senior Lien Bond Interest and Sinking Fund) shall be pledged to the payment of such series that is not a Reserve Fund Participant.

The Subordinate Lien Bond Interest and Sinking Fund shall constitute trust funds which shall be held in trust for the Owners of the Subordinate Lien Bonds to which they are pledged and the proceeds of which (other than the interest income thereon, which may be transferred to the extent herein provided to the Revenue Fund or such other Funds as may be required under federal tax law) shall be pledged to the payment of the Subordinate Lien Bonds. The Subordinate Lien Bond Reserve Fund shall constitute trust funds which shall be held in trust for the Owners of the Subordinate Lien Bonds to which they are pledged and the proceeds of which (other than the interest income thereon, which may be transferred to the extent herein provided to the Subordinate Lien Interest and Sinking Fund) shall be pledged to the payment of the Subordinate Lien Bonds. ***Within the Subordinate Lien Bond Reserve Fund, there shall be created a Subordinate Lien Bond Reserve Fund Participant Account, which account shall constitute trust funds and shall be held in trust for***

***Owners of the Subordinate Lien Bonds to which they are pledged. The proceeds of the Subordinate Lien Bond Reserve Fund Participant Account (other than the interest income thereon, which may be transferred to the Subordinate Lien Bond Interest and Sinking Fund) shall be pledged to the payment of the Subordinate Lien Bonds that are Reserve Fund Participants. All Subordinate Lien Bonds Outstanding on the date of adoption of this Ordinance are declared and designated to be Reserve Fund Participants. The Series 2011 Bonds are also declared and designated to be Reserve Fund Participants. The City may issue Additional Subordinate Lien Bonds which may be designated as Reserve Fund Participants. The City also reserves the right to issue Additional Subordinate Lien Bonds which are not designated as Reserve Fund Participants and are not secured by the Subordinate Lien Bond Reserve Fund Participant Account; provided that the City may create a separate account(s) within the Subordinate Lien Bond Reserve Fund for the benefit of any such series that is not a Reserve Fund Participant, the proceeds of which account (other than the interest thereon, which may be transferred to the Subordinate Lien Bond Interest and Sinking Fund) shall be pledged to the payment of such series that is not a Reserve Fund Participant.***

All of the Funds named above shall be used solely as herein provided so long as any Bonds remain Outstanding.

The City reserves the right to create additional accounts within any Fund as necessary or desirable in furtherance of the intent and purpose of this Ordinance.

SECTION 5.05 No Amendments Proposed.

SECTION 5.06 No Amendments Proposed.

SECTION 5.07 No Amendments Proposed.

SECTION 5.08 No Amendments Proposed.

SECTION 5.09 SUBORDINATE LIEN BOND RESERVE FUND. (a) The City shall establish and maintain as hereinafter provided a balance in the Subordinate Lien Bond Reserve Fund ***Participant Account of the Subordinate Lien Bond Reserve Fund*** equal to the Reserve Fund Requirement for the Subordinate Lien Bonds ***that are secured thereby. With respect to any series of Subordinate Lien Bonds that are not Reserve Fund Participants, the City shall establish and maintain a balance in the accounts created within the Subordinate Lien Bond Reserve Fund for such series equal to the Reserve Fund Requirement for the Subordinate Lien Bonds that are secured thereby.*** Each increase in the Reserve Fund Requirement resulting from the issuance of any Additional Subordinate Lien Bonds shall be satisfied at the time of issuance and delivery of such series of Additional Subordinate Lien Bonds.

The Reserve Fund Requirement shall be satisfied by depositing to the credit ***of the Subordinate Lien Bond Reserve Fund Participant Account (in the case of Additional Subordinate Lien Bonds that are Reserve Fund Participants) or such other designated accounts (in the case of Additional Subordinate Lien Bonds that are not Reserve Fund Participants)*** of the Subordinate Lien Bond Reserve Fund either (i) proceeds of such Additional Subordinate Lien Bonds or other lawfully appropriated funds in not less than the amount which, together with investment earnings thereon as estimated by the City, will be sufficient to fund fully the Reserve Fund Requirement by no later than the end of the period of time for which the payment of interest on such Additional Subordinate Lien Bonds has been provided out of proceeds of such Additional Subordinate Lien Bonds or investment earnings thereon as estimated by the City or from other lawfully available funds other than Net Revenues or (ii) a surety bond, insurance policy or letter of credit in a principal amount equal to the amount required to be funded, provided that, at the time of deposit, either the rating for the long-term unsecured debt of the issuer of such surety bond, insurance policy or letter of credit or the rating for obligations insured, secured or guaranteed by such issuer are required to be in one of the two highest letter categories by at least ***one*** major municipal securities evaluation ***service*** (or, if such entities are no longer in existence, by comparable services) and which Subordinate Lien Bond Reserve Fund Surety Policy shall be payable on demand of the City for the benefit of the Owners of the Subordinate Lien Bonds that are secured thereby (collectively, a “Subordinate Line Bond Reserve Fund Surety Policy”).

(b) In any month in which ***any account of*** the Subordinate Lien Bond Reserve Fund contains less than the ***applicable*** Reserve Fund Requirement (or so much thereof as shall then be required to be therein if the City has elected to accumulate the Reserve Fund Requirement for any series of Additional Subordinate Lien Bonds as above provided), then on or before the last business day of such month, after making all required payments and provision for payment of

Operation and Maintenance Expenses, and after making all required transfers to the Senior Lien Bond Interest and Sinking Fund, the Senior Lien Bond Reserve Fund and the Subordinate Lien Bond Interest and Sinking Fund, there shall be transferred ***on a pro rata basis into the Subordinate Lien Reserve Fund Participant Account (in the case of Subordinate Lien Bonds that are Reserve Fund Participants) and such other designated accounts (in the case of Subordinate Lien Bonds that are not Reserve Fund Participants) of the Subordinate Lien Bond Reserve Fund from the Revenue Fund, such amounts as shall be required to permit the City to pay all reimbursement obligations under the Subordinate Lien Bond Reserve Fund Surety Policies allocable to the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, within a 12-month period and such additional amounts as shall be sufficient to enable the City within a 12-month period to re-establish in the Subordinate Lien Bond Reserve Fund Participant Account or such other designated accounts, as applicable, the Reserve Fund Requirement for the Subordinate Lien Bonds secured thereby; provided, however, that in the event that such monthly transfer requirements ever exceed 1/12<sup>th</sup> of the maximum Debt Service Requirements scheduled to occur in any future Fiscal Year on all Subordinate Lien Bonds then Outstanding (being the maximum transfer permitted by Section 5.09 of the prior ordinance authorizing the Subordinate Lien Bonds), any remaining required transfers shall be accomplished pursuant to Section 5.13 below.*** After such amounts have been accumulated in the Subordinate Lien Bond Reserve Fund ***Participant Account and such other designated accounts (as described above)***, and so long thereafter as such ***accounts contain such amounts***, no further transfers shall be required to be made into the Subordinate Lien Bond Reserve Fund ***Participant Account or such other designated accounts***, and any excess amounts in such ***accounts shall be transferred to the Subordinate Lien Bond Interest and Sinking Fund to the extent the excess is attributable to the Subordinate Lien Bond Reserve Fund for any tax-exempt Subordinate Lien Bonds, and otherwise,*** solely to the extent required by federal tax law, shall be transferred to the Revenue Fund or such other Funds as may be required by federal tax law. But if and whenever the balance in the Subordinate Lien Bond Reserve Fund ***Participant Account or such other designated accounts*** is reduced below such amount, monthly transfers to such ***accounts*** shall be resumed and continued in such amounts as shall be required to restore the Subordinate Lien Bond Reserve Fund ***Participant Account or such other designated accounts, as applicable,*** to such amount within a 12-month period.

The Subordinate Lien Bond Reserve Fund ***Participant Account*** shall be used to pay the principal of and interest on the Subordinate Lien Bonds ***that are Reserve Fund Participants*** at any time when there is not sufficient money available in the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments ***on deposit in such account*** be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policies ***allocable to the Subordinate Lien Bond Reserve Fund Participant Account)*** and to repay amounts drawn under any Subordinate Lien Bond Reserve Fund Surety Policy allocable to such Subordinate Lien Bond Reserve Fund ***Participant Account for such purpose, together with interest thereon, in accordance with the terms of the City's reimbursement obligations incurred in connection with such Subordinate Lien Bond Reserve Fund Surety Policy. The Subordinate Lien Bond Reserve Participant Account may also be used to make the final payments for the retirement or defeasance of all Subordinate Lien Bonds then Outstanding that are secured thereby.***

***With respect to any series of Subordinate Lien Bonds that are not Reserve Fund Participants, any account created within the Subordinate Lien Bond Reserve Fund for the benefit of such series of Subordinate Lien Bonds shall be used to pay the principal and interest on such series of Subordinate Lien Bonds at any time when there is not sufficient money available if the Subordinate Lien Bond Interest and Sinking Fund for such purpose (with the requirement that all cash and investments on deposit in such account be depleted before drawing upon any Subordinate Lien Bond Reserve Fund Surety Policy, unless provided otherwise in each of the Subordinate Lien Bond Reserve Fund Surety Policies allocable to such account) and to repay amounts drawn under any Subordinate Lien Bond Reserve Fund Surety Policy allocable to such account for such purpose, together with interest thereon, in accordance with the terms of the City's reimbursement obligations incurred in connection with such Subordinate Lien Bond Reserve Fund Surety Policy. Any such account may also be used to make the final payments for the retirement and defeasance of the series of Subordinate Lien Bonds then Outstanding that are secured thereby.***

(c) The City directs and requires the paying agent for any series of Subordinate Lien Bonds to ascertain the necessity for claim or draw upon the applicable Subordinate Lien Bond Reserve Fund Surety Policy, and to provide notice to the issuer thereof in accordance with its terms and to make such claims or draws thereon as may be necessary to provide for the timely payment of principal and interest on the Subordinate Lien Bonds to which it pertains.

SECTION 5.10 No Amendments Proposed.

SECTION 5.11 No Amendments Proposed.

SECTION 5.12 No Amendments Proposed.

SECTION 5.13 No Amendments Proposed.

SECTION 5.14 No Amendments Proposed.

SECTION 5.15 No Amendments Proposed.

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**APPENDIX C**  
**FORM OF OPINION OF CO-BOND COUNSEL**

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BRACEWELL & GIULIANI LLP  
711 LOUISIANA STREET, SUITE 2300  
HOUSTON, TEXAS 77002-2770

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

[Closing Date]

WE HAVE ACTED as co-bond counsel for the CITY OF HOUSTON, TEXAS (the “City”) in connection with the issuance of the CITY OF HOUSTON, TEXAS AIRPORT SYSTEM SUBORDINATE LIEN REVENUE REFUNDING BONDS, SERIES 2012A (AMT) in the original aggregate principal amount of \$286,585,000 (the “Series 2012A Bonds”) and the CITY OF HOUSTON, TEXAS AIRPORT SYSTEM SUBORDINATE LIEN REVENUE REFUNDING BONDS, SERIES 2012B (NON-AMT) in the original aggregate principal amount of \$217,135,000 (the “Series 2012B Bonds” and together with the Series 2012A Bonds, the “Series 2012 Bonds”).

The Series 2012 Bonds mature, bear interest and may be transferred and exchanged as set forth in the Series 2012 Bonds, City Ordinance No. 2012-100 (the “Ordinance”) and the officers pricing certificate authorizing their issuance. Capitalized terms used herein but not otherwise defined shall have the meaning assigned to them in the Ordinance.

WE HAVE ACTED as co-bond counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Series 2012 Bonds under the Constitution and laws of the State of Texas and with respect to the exclusion of interest on the Series 2012 Bonds from gross income for federal income tax purposes. We have not investigated or verified original proceedings, records, data or other material, but have relied solely upon the transcript of certified proceedings described in the following paragraph. We have not assumed any responsibility with respect to the financial condition or capabilities of the City, including the Airport System, or the disclosure thereof in connection with the offer and sale of the Series 2012 Bonds. Our role in connection with the City’s Official Statement, dated March 7, 2012, prepared for use in connection with the offer and sale of the Series 2012 Bonds has been limited as described therein.

IN OUR CAPACITY as co-bond counsel, we have participated in the preparation of and have examined a transcript of certified proceedings pertaining to the authorization and issuance of the Series 2012 Bonds and the bonds being refunded with the proceeds of the Series 2012 Bonds (the “Refunded Bonds”), on which we have relied in giving our opinion. The transcript contains certified copies of certain proceedings of the City Council of the City; the report of Grant Thornton LLP, certified public accountants, (the “Report”) verifying the sufficiency of the deposits made with the Refunded Bonds Escrow Agent for the defeasance and redemption of the Refunded Bonds and the mathematical accuracy of certain computations of the yield of the Series 2012 Bonds and the escrowed securities acquired with the proceeds of the Series 2012 Bonds; customary certificates of officials, agents and representatives of the City, the Refunded Bonds Escrow Agent, and certain other persons; and other certified showings relating to the

authorization and issuance of the Series 2012 Bonds and firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds. We have further examined such applicable provisions of the Internal Revenue Code of 1986, as amended (the “Code”), court decisions, regulations and published rulings of the Internal Revenue Service (the “Service”) as we have deemed relevant. We have also examined a specimen of the form of registered bond of each series of this issue.

BASED ON SUCH EXAMINATION, IT IS OUR OPINION THAT:

1. The transcript of certified proceedings referenced above evidences complete legal authority for the issuance of the Series 2012 Bonds in full compliance with the Constitution and the laws of the State of Texas presently effective and that therefore the Series 2012 Bonds constitute legal, valid and binding special obligations of the City;
2. The Series 2012 Bonds, together with all outstanding Subordinate Lien Bonds and any additional Subordinate Lien Bonds hereafter issued, are payable from and equally and ratably secured by a lien on the Net Revenues of the Airport System (subject to the prior and superior lien on Net Revenues securing the outstanding Senior Lien Obligations and any additional Senior Lien Obligations hereafter issued) and the Subordinate Lien Bond Interest and Sinking Fund, as provided in the Ordinance. The Series 2012 Bonds are also secured by a lien on the Subordinate Lien Bond Reserve Fund Participant Account, as provided in the Ordinance; and
3. Under the terms of the Ordinance and certain certificates and letters of instruction delivered thereunder, firm banking and financial arrangements have been made for the discharge and final payment of the Refunded Bonds pursuant to a Refunded Bonds Escrow Agreement(s) entered into between the City and the Refunded Bonds Escrow Agent effective as of the date of delivery of the Series 2012 Bonds, and therefore the Refunded Bonds are deemed to be fully paid and no longer outstanding except for the purpose of being paid from funds provided for such purpose pursuant to the Refunded Bonds Escrow Agreement.

THE RIGHTS OF THE OWNERS of the Series 2012 Bonds are subject to the applicable provisions of the federal bankruptcy laws and any other similar laws affecting the rights of creditors of political subdivisions, and may be limited by general principles of equity which permit the exercise of judicial discretion. The Series 2012 Bonds are secured solely by a lien on and pledge of Net Revenues of the Airport System as described above and certain funds as provided in the Ordinance and do not constitute an indebtedness or general obligation of the City. Owners of the Series 2012 Bonds shall never have the right to demand payment of principal or interest out of any funds raised or to be raised by taxation.

THE CITY HAS RESERVED THE RIGHT TO ISSUE ADDITIONAL SENIOR LIEN OBLIGATIONS, SUBORDINATE LIEN BONDS AND INFERIOR LIEN BONDS, subject to the restrictions contained in the Ordinance, secured by liens on the Net Revenues that are prior

and superior to, on a parity with, or junior and inferior to, respectively, the lien on Net Revenues securing the Series 2012 Bonds.

IT IS OUR FURTHER OPINION THAT:

4. Interest on the Series 2012A Bonds is excludable from gross income for federal income tax purposes under existing law, except for any period a Series 2012A Bond is held by a person who, within the meaning of Section 147(a) of the Code, is a “substantial user” or a “related person” to a “substantial user” of the facilities that were financed with, or treated as financed with, the proceeds of the Series 2012A Bonds; and

5. The Series 2012A Bonds are “private activity bonds” within the meaning of the Code, and interest on the Series 2012A Bonds is an item of tax preference that is includable in alternative minimum taxable income for purposes of determining the alternative minimum tax imposed on individuals and corporations; and

6. Interest on the Series 2012B Bonds is excludable from gross income for federal income tax purposes under existing law; and

7. The Series 2012B Bonds are not “private activity bonds” within the meaning of the Code, and as such, interest on the Series 2012B Bonds is not subject to the alternative minimum tax on individuals and corporations, except that interest on the Series 2012B Bonds will be included in the “adjusted current earnings” of a corporation (other than any S corporation, regulated investment company, REIT or REMIC) for purposes of computing its alternative minimum tax liability.

In providing such opinions, we have relied on representations of the City, the City's co-financial advisors and the Underwriters with respect to matters solely within the knowledge of the City, the City's co-financial advisors and the Underwriters, respectively, which we have not independently verified. We will further rely on the Report regarding the mathematical accuracy of certain computations. In addition, we have assumed for purposes of this opinion continuing compliance with the covenants in the Ordinance pertaining to those sections of the Code that affect the exclusion from gross income of the interest on the Series 2012 Bonds for federal income tax purposes. In the event that such representations or the Report are determined to be inaccurate or incomplete, or if the City fails to comply with the foregoing covenants in the Ordinance, interest on the Series 2012 Bonds could become includable from the date of their original delivery, regardless of the date on which the event causing such inclusion occurs.

Except as stated above, we express no opinion as to any federal, state or local tax consequences resulting from the ownership of, receipt or accrual of interest on or disposition of the Series 2012 Bonds.

Owners of the Series 2012 Bonds should be aware that the ownership of tax-exempt obligations may result in collateral federal income tax consequences to financial institutions, life insurance and property and casualty insurance companies, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, and individuals otherwise qualifying for the earned

income credit. In addition, certain foreign corporations doing business in the United States may be subject to the “branch profits tax” on their effectively-connected earnings and profits (including tax-exempt interest such as interest on the Series 2012 Bonds).

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement these opinions to reflect any facts or circumstances that may hereafter come to our attention or to reflect any changes in law that may hereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Service; rather, such opinions represent our legal judgment based upon our review of existing law and in reliance upon the representations and covenants referenced above that we deem relevant to such opinions. The Service has an ongoing audit program to determine compliance with rules that relate to whether interest on state or local obligations is includable in gross income for federal income tax purposes. No assurance can be given regarding whether or not the Service will commence an audit of the Series 2012 Bonds. If an audit is commenced, in accordance with its current published procedures, the Service is likely to treat the City as the taxpayer. We observe that the City has covenanted in the Ordinance not to take any action, or omit to take any action within its control, that if taken or omitted, respectively, may result in the treatment of interest on the Series 2012 Bonds as includable in gross income for federal income tax purposes.

## APPENDIX D

### SUMMARY OF SCHEDULES RELATED TO CONTINUING DISCLOSURE OF INFORMATION

Schedule 1	Passenger Statistics (including Schedule 1-A – Total Enplaned Passengers for the Houston Airport System)
Schedule 2	Airline Market Shares
Schedule 3	Total Aircraft Operations and Aircraft Landed Weight
Schedule 4	Total System Cargo Activity
Schedule 5	Selected Financial Information
Schedule 6	Summary of Certain Fees and Charges
Schedule 7	Houston Airport System Debt Service Requirements Schedule
Schedule 8	Houston Airport System Outstanding Debt
Schedule 8A	Cash and Liquidity
Schedule 9*	Municipal System Pension Plan Assets, Liabilities, and Unfunded Actuarial Accrued Liability

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\* The City agrees and is obligated to update Schedule 9 only to the extent that the City receives updated actuarial reports from the board of the Municipal Employees Pension System (the “Pension System”). The City is not empowered to require the board of the Pension System to obtain updated actuarial reports. The Pension System will periodically receive additional actuarial reports with regard to the City’s pension plans, to the extent required under State law or requested by the board of the Pension System. Accordingly, an updated Schedule 9 may not be available in every annual continuing disclosure filing.

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## APPENDIX E

### DEPOSITORY TRUST COMPANY

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

#### **The Depository Trust Company**

Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the Series 2012 Bonds. The Series 2012 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each maturity of the Series 2012 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of Series 2012 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2012 Bonds on DTC’s records. The ownership interest of each actual purchaser of each Security (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2012 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2012 Bonds, except in the event that use of the book-entry system for the Series 2012 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2012 Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2012 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2012 Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Series 2012 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2012 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events

with respect to the Series 2012 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the financing documents. For example, Beneficial Owners of the Series 2012 Bonds may wish to ascertain that the nominee holding the Series 2012 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 2012 Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such a maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2012 Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2012 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series 2012 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from Issuer or Bond Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Bond Trustee, or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest on the Series 2012 Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Issuer or the Bond Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series 2012 Bonds at any time by giving reasonable notice to the Issuer or the Bond Trustee. Under such circumstances, in the event that a successor depository is not obtained, Series 2012 Bond certificates are required to be printed and delivered.

The Issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Series 2012 Bond certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Issuer believes to be reliable, but the Issuer takes no responsibility for the accuracy thereof.



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