

AN ELEVATED EXPERIENCE

ANNUAL REPORT 2016



The background of the entire page is a photograph of an airport terminal. On the left, there is a blurred view of a moving walkway. On the right, there are large windows with colorful, abstract art pieces displayed in the panes. The overall lighting is bright and modern.

The Houston Airport System (HAS) provides a safe and dynamic air service network that fosters economic vitality for the transportation industry and the greater Houston region. Bringing air service to the more than six million people living in the Houston area are three airport facilities: George Bush Intercontinental Airport, William P. Hobby Airport and Ellington Airport, a joint-use airport that accommodates general aviation flights, U.S. government operations and Houston Spaceport. The two commercial airports served nearly 55 million passengers in 2016, including more than 11 million international travelers.

OUR MISSION

To connect the people, businesses, cultures and economies of the world to Houston.

OUR VISION

Establish Houston as a five-star global air service gateway where the magic of flight is celebrated.

CORE VALUES

RELATIONSHIPS

We honor our commitments and earn trust.

INNOVATION

We consider unconventional ways of thinking.

SERVICE

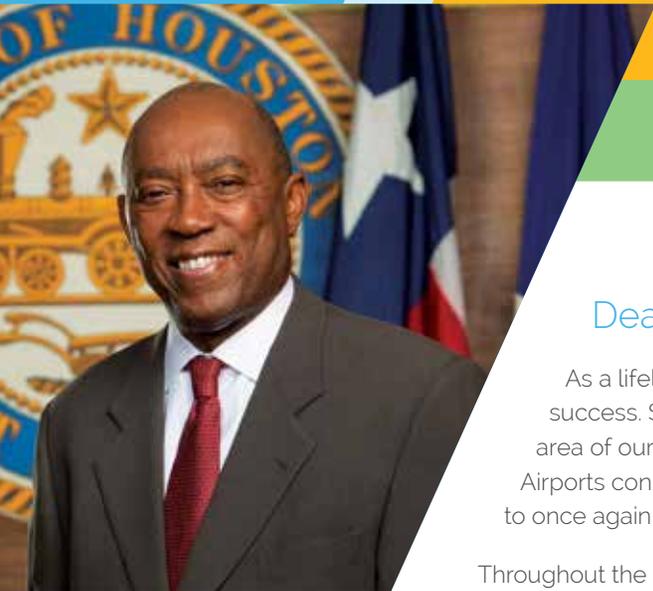
We WOW our customers through a "can-do" attitude.

EXCELLENCE

We strive for skillful execution without compromise.

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Dear Houstonians,

As a lifelong Houstonian, I have long been aware of the key role that our airports play in both our economic and cultural success. Since being sworn in as the city's Mayor in 2016, I have developed an even greater appreciation for the vital role this area of our operation plays in the Greater Houston region and beyond. George Bush Intercontinental and William P. Hobby Airports connect the people, businesses, cultures and economies of the world to Houston, while Ellington Airport stands poised to once again solidify Houston's standing as "Space City, U.S.A."

Throughout the course of 2016, we have witnessed a number of exciting developments taking place at our three airport facilities. Construction projects, customer service enhancements and cutting-edge initiatives are moving forward to improve the overall customer experience. The Houston Airports team is redoubling its efforts to establish and maintain "an elevated experience" at all three of our airport facilities, and that focus is already yielding industry-leading results.

The City of Houston had unique opportunities to prepare for as it hosted major events. The first part of 2016 witnessed the arrival of the NCAA Men's Championship "Final Four" basketball tournament in Houston. The city closed the year by rolling out the red carpet for NFL fans as they arrived for Super Bowl LI. Both of these major sporting events were widely hailed as remarkably successful. That accomplishment is due in large part to the preparation and coordination undertaken by the Houston Airports team.

Of course, when you're the "global gateway" for the nation's fourth-largest city, there is no time to rest on previous accomplishments. The drive toward a "five-star experience" is all-encompassing, touching virtually every area of each airport's operation. At George Bush Intercontinental Airport, for example, a new Terminal C North was constructed, which not only dramatically improved the immediate landscape but also cleared a path for a new international terminal to be completed by 2022. A new parking garage was the significant development at William P. Hobby Airport in 2016, while Ellington Airport enjoyed significant strides in developing the infrastructure necessary for the development of Houston Spaceport.

The theme for this year's report, "An Elevated Experience," perfectly captures the goals and aims of the Houston Airports team. In recent years, Houston has enjoyed remarkable success in expanding and enhancing its global route map, adding new air carriers and convincing existing airlines to adopt new routes. Now, the focus is on creating a complete and memorable customer experience that accurately reflects Houston's standing as a vibrant and exciting community. This annual report reflects those sincere efforts.

Dear Stakeholders,

Today's air traveler is savvy, informed, prepared and connected. Technology gives passengers a wealth of information and, in many ways, power to be in control of their journey. But, with that enhanced level of knowledge also comes heightened expectations. The theme of Houston Airport System's 2016 annual report — "An Elevated Experience" — focuses on the many ways our three airport facilities worked to not just meet those heightened expectations, but also to exceed them.

The Houston Airport System is comprised of three distinct airport facilities: George Bush Intercontinental Airport, William P. Hobby Airport and Ellington Airport. Each serves the Houston community in its own unique way and each has taken steps to provide an elevated experience for the nearly 55 million passengers we served in 2016. These steps include ambitious and vital construction and renovations, the introduction of new service, expanded and enhanced concession choices, and technological advancements. No matter the mode, the overall goal remained the same: providing a complete and enjoyable experience for every airport visitor.

A big part of reaching this goal is an ambitious program that will completely alter the concessions landscape at both George Bush Intercontinental Airport and William P. Hobby Airport. When completed in 2017, every Houston Airports restaurant and retail outlet will be either a newly constructed addition or a dramatically remodeled existing operation, providing passengers access to 120 new outlets at Houston's two commercial airports.

Technology is at the heart of today's modern airport, and Houston's airports delivered the kind of advancements travelers expect and need. We unveiled a new award-winning website — fly2houston.com — designed to provide customers with all the travel information they need on a variety of airport topics, ranging from parking and shopping to flight information and beyond. The reimagined website immediately proved to be an invaluable tool by offering individualized information specifically related to the user's distinct journey.

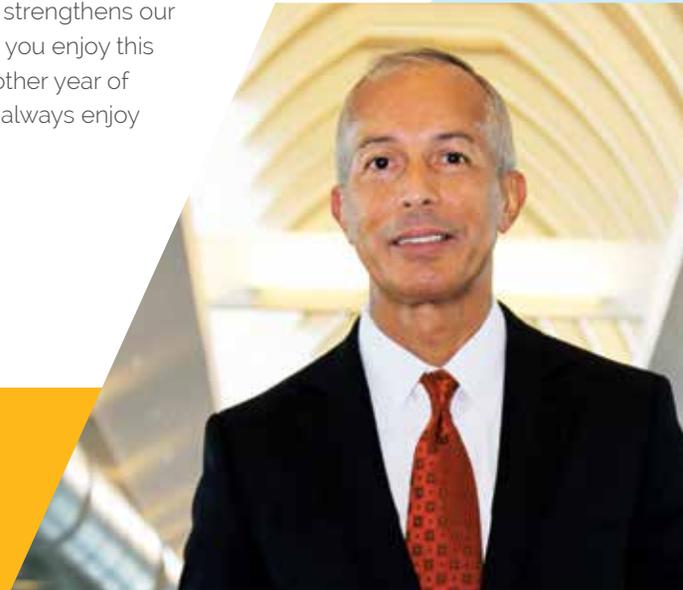
These are just two examples of the many efforts undertaken in 2016. Elevating services for all our customers strengthens our vision of establishing Houston as a five-star global gateway where the magic of flight is celebrated. I hope that you enjoy this retrospective of the Houston Airport System's accomplishments in 2016. And while we pause to look back at another year of growth, we pledge to continue working toward meeting the evolving needs and desires of our customers so they always enjoy "An Elevated Experience."



A handwritten signature in black ink that reads "Mario Diaz".

Mario Diaz

Director of Aviation
Houston Airport System



LEADERSHIP

TEAM



MARIO DIAZ
Director of Aviation

BALRAM BHEODARI
Chief Operations Officer



IAN WADSWORTH
Chief Commercial Officer



SABA ABASHAWL
Chief External Affairs Officer



ROBERT BARKER
Chief Development Officer – Infrastructure



JESUS H. SAENZ JR.
General Manager – Hobby Airport



ARTURO MACHUCA
General Manager – Ellington Airport



TED KITCHENS
General Manager – Intercontinental Airport



HARLEEN HINES SMITH
Chief Human Resources Officer



LISA KENT
Chief Information Officer



MATT TOWNSEND
Chief Financial Officer



AN ELEVATED EXPERIENCE



Houston Airports is firmly committed to the idea of constantly improving the overall experience enjoyed by its customers at all three airport facilities. At times, this effort involves the construction and/or renovation of buildings, while on other occasions, the drive toward improvement may simply call for the introduction of a new service or technological advancement. The methods of improvement may change on a case-by-case basis but the overall goal remains the same. Throughout 2016, Houston Airports took a number of major steps forward in offering 55 million passengers the most enjoyable experience possible.



NEW CONCESSIONS PROGRAM

At the heart of the elevated experience was a new concessions program that is expected to reach \$1.6 billion in sales over the 10-year period that will completely enhance the landscape at both George Bush Intercontinental Airport and William P. Hobby Airport. By the time the program had reached completion in early 2017, every restaurant and retail outlet under Houston Airports' control was either a newly constructed addition or a dramatically remodeled existing operation.

This means that passengers now have access to 120 new outlets at Houston's two commercial airports, bringing them a host of fresh new options in restaurants, retail shops, service amenities and more.

Throughout the new concessions, customers are finding a refreshing mix of fast casual and high-end dining choices, including a number of recognized Texas-based restaurants that highlight the "local flavor" of America's fourth-largest city.

The award-winning collection of national, regional and local brands is bringing a fresh look and feel to both George Bush Intercontinental Airport and William P. Hobby Airport, with 43 new food and beverage shops and 77 new retail outlets opening their doors to customers.

Expected sales over 10 years: \$1.6 Billion

43 new food and beverage shops

77 new retail outlets

147,800 square feet



CORSA
COLLECTIONS



120 NEW CONCESSIONS OUTLETS

GEORGE BUSH INTERCONTINENTAL AIRPORT

TERMINAL A

Terminal A is a terrific example of the type of variety that can now be found throughout the concessions at George Bush Intercontinental Airport. Restaurants, such as Blaze Pizza and The Breakfast Klub, offer new tastes. Terminal A customers also can find distinctive flavors at the Cadillac Mexican Kitchen & Tequila Bar, the Hubcap Grill & Beer Yard and other eateries. In addition, Terminal A offers a pre-security dining option (SUBWAY) and a choice between three Starbucks. From a shopping standpoint, Terminal A has something for every sweet tooth and souvenir hunter with Dylan's Candy Bar and City Point.

TERMINAL B

With the opening of a new Terminal B South just a few years ago, customers are now enjoying a list of dining options that include 3rd Bar Eating House, Ray's BBQ Shack, Barcuterie and more. While the B North portion is slated for reconstruction in the future, customers can find excellent shopping at the iStore and Johnston & Murphy.

TERMINAL C

Like its neighbor, Terminal C is at the midway point of a dramatic transformation. Terminal C North now offers some of the finest dining and shopping options found in any airport setting, including Bam Bam and Ember. Thousands of iPads are on hand to assist in placing food orders. Shopping needs are covered by Hugo Boss, Jo Malone, Manready Mercantile and Tumi.





TERMINAL D

As a primary international gateway and the home to all foreign flag carriers, Terminal D plays a vital role within the Houston Airports operation. The facility reflects Houston's vibrant and diverse culinary scene at Hugo's Cocina and Tony's Wine Cellar & Bistro, along with shopping at ATU Duty Free, Chanel, Pandora and Corsa Collections.

TERMINAL E

Terminal E offers a remarkable collection of both restaurants and retail shops. Passengers can choose to eat at a Pappadeaux Seafood Kitchen, Cat Cora's, Le Grand Comptoir, or La Tapenade Mediterranean Café, before finding the perfect gift at either Bluwire, Eddie Bauer or Johnston & Murphy.

WILLIAM P. HOBBY AIRPORT

William P. Hobby Airport added exciting dining and shopping options to the new international concourse to complement the highly-rated existing options in the main terminal and pre-security. Passengers are now delighted to find Mac Cosmetics, Dylan's Candy Store, Yia Yia Mary's, Chick-fil-A and more.





PASSENGER FACILITATION

PRECHECK ENROLLMENT CENTERS

One of the more popular expedited screening programs at airports in recent years is the Transportation Security Administration's (TSA) PreCheck program. Enrolling in the program is easier than ever before. In 2016, Houston Airports partnered with the TSA to create two PreCheck enrollment centers at George Bush Intercontinental Airport and one center at William P. Hobby Airport. Passengers can now access these enrollment centers at their pre-security checkpoint location. The PreCheck program allows enrolled passengers to pass through the security checkpoint while wearing their shoes, light outerwear and belt. These passengers also can keep their laptop in its case and 3-1-1 compliant liquids/gels in a carry-on bag.

MOBILE PASSPORT CONTROL

Mobile Passport Control (MPC) represents a perfect example of this commitment to fully utilize technology in the drive to efficiently move passengers through the various steps necessary for airport travel. Designed to assist people who are arriving in Houston aboard international flights, MPC allows eligible passengers to submit their passport information and answers to inspection-related questions to CBP personnel via smartphone or tablet app prior to arrival. In the past, this data was collected by passengers filling out information cards while either on the aircraft prior to landing or in the terminal prior to reaching the security booths. But now, that data is ready and waiting for CBP screeners and can be obtained with a simple scan of the passenger's electronic device. The MPC technology is available at both George Bush Intercontinental Airport and William P. Hobby Airport.





ENHANCED TECHNOLOGY

Today's air travelers rely on technology like never before in their quest to navigate the airport setting as efficiently as possible. Working with stakeholder partners, including the Transportation Security Administration and U.S. Customs & Border Protection, Houston Airports understands this 21st century trend and constantly looks for new ways to further incorporate these technological tools into the overall travel experience. With the travel experience in mind, dramatic improvements also were made in the customer's access to electrical outlets and USB ports. In 2016, more than 900 new power outlets and USB ports were placed in high-traffic areas throughout the two commercial airports. Electrical outlets now can be found in every food and beverage unit overseen by the Houston Airports team.



REIMAGINED WEBSITE

On May 23, 2016, Houston Airports unveiled a sleek and exciting new website designed to provide customers with all the information they need on a variety of airport topics, ranging from parking to flight information, dining, shopping and beyond. Creating separate paths for customers at Bush Intercontinental and Hobby Airports, the reimagined fly2houston.com website immediately proved to be an invaluable tool by offering individualized information specifically related to the user's distinct journey. The result has been a record increase in the number of users utilizing the site.

IAH OPENED 8,500 SQUARE FEET OF LUXURY

ENHANCED AMENITIES

George Bush Intercontinental and William P. Hobby Airports offer passengers much more than just a "waiting area" for their individual flights. Houston Airports constantly is looking for new features and amenities that will create a "WOW factor" for guests. This effort, which often involves detailed coordination with our partners, can touch virtually every aspect of the operation, ranging from restroom facilities to lounges and hotel accommodations.

AMERICAN EXPRESS CENTURION LOUNGE

On June 22, 2016, George Bush Intercontinental Airport opened 8,500 square feet of luxury, with the grand opening of the American Express Centurion Lounge, one of only seven such lounges created by the American Express team at U.S. airports. Located in the Mickey Leland International Terminal (Terminal D), the lounge offers select card members a unique and plush environment in which to relax and recharge before flying. Providing an array of amenities, such as a Houston-inspired menu created by Chef Justin Yu, complimentary full bar and select wine list, the premier Centurion Lounge creates a memorable travel experience intrinsic to Houston's culture.



HOUSTON AIRPORT MARRIOTT

A valued part of George Bush Intercontinental Airport for 45 years, the Houston Airport Marriott unveiled a multi-million-dollar makeover on January 12, 2016, when newly elected Mayor of Houston Sylvester Turner led the ribbon-cutting to celebrate the dramatic renovation of the 573-room hotel located at the heart of the airport. The property-wide transformation of the hotel — which first opened at Bush Intercontinental in 1971 — extends from the exterior to guestrooms, suites, meeting rooms, lobby, restaurants, public areas and fitness center. All areas have been reimagined with a modern style and design that focuses on improving the overall guest experience, delivering on the flagship brand's promise of "Traveling Brilliantly." With the makeover, the Houston Airport Marriott provides an elevated option for meetings, business trips and leisure stays with the added convenience of being located at the heart of George Bush Intercontinental Airport.



REMODELED RESTROOM FACILITIES

The newly remodeled restroom facilities in the Mickey Leland International Terminal at George Bush Intercontinental Airport represent a sparkling example of the Houston Airports team listening directly to its customers in order to prioritize the list of needed improvements. With these facilities consistently ranking at or near the top of the passenger's wish list, Houston Airports set out to meet this request in dramatic fashion. The result is a set of stunning facilities that combine modern aesthetics and functional efficiency. Eight different bathroom units were completely renovated at George Bush Intercontinental Airport, with another eight units completed at William P. Hobby Airport. Future enhancements will include a touchscreen user-satisfaction system that will immediately gauge the customer's reaction to the facility and will notify the cleaning staff if attention is required.



Therapy Dog Program

The Houston Airport System launched a therapy dog program in March 2016 at George Bush Intercontinental Airport. The program offers a fun way to help folks relax if traveling gets a little "ruff." Volunteer dog teams, readily identifiable by the handlers' bright orange polo shirts and the dogs' blue bandanas, make their way through the various terminals to the gates, offering passengers an opportunity to pet and interact with some furry, four-legged ambassadors.



REACHING THE WORLD

First and foremost, Houston Airports exist to connect the people, businesses, cultures and economies of the world to Houston. The Houston market continued to support the many new services that launched in 2015, and in 2016, a host of enhancements and expansions from existing airline partners were witnessed. An influx of new service particularly impactful for destinations in Latin America and the Caribbean was also noted.



CUBA

One of the more exciting recent launches at George Bush Intercontinental Airport involves the establishment of regularly scheduled commercial air service between Houston and Havana, Cuba. United Airlines established nonstop air service between Havana and its key Texas hub. The inaugural flight took off on December 3, 2016, with Houston Mayor Sylvester Turner joining Houston Airport System's Director of Aviation Mario Diaz greeting passengers at the departure gate.

Bush Intercontinental Airport is United's gateway to Latin America, with 82 daily nonstop flights to 55 destinations across Latin America and the Caribbean from its Houston hub.



Fast Facts

Only nonstop to Cuba from southwest region of U.S.

Flight operates each Saturday

Flies into José Martí International Airport in Havana, Cuba



In addition to establishing air service to Cuba, Houston Airports saw new and expanded air service options across its international route map. In the fourth quarter of the year, EVA Air, Singapore Airlines and Air New Zealand all made either significant enhancements to existing schedules or launched service to new destinations.

October 3, 2016: EVA Air upgraded its schedule to Taipei, Taiwan by moving to daily nonstop service between George Bush Intercontinental Airport and Taoyuan International Airport, located just outside of Taipei.

October 30, 2016: Singapore Airlines launched a new nonstop flight, connecting Houston's George Bush Intercontinental Airport to Manchester, England. The new five-days-a-week service is Singapore Airlines' first transatlantic flight between the United States and the United Kingdom.

December 16, 2016: Air New Zealand initially launched air service in Houston in mid-December 2015, operating five flights per week. In December 2016, they expanded the Auckland - Houston route to a daily schedule for their peak season of December through February.



ANA "Star Wars" Jet Lands in Houston

The All Nippon Airways (ANA) "Star Wars" Boeing 777-300 landed in Houston on April 14, 2016.

The BB-8™ ANA JET is one of three ANA aircraft decorated with characters from the movie "Star Wars: The Force Awakens." Passengers on the BB-8™ ANA JET experience the world of "Star Wars" with specially-designed BB-8 paper cups and headrest covers. In addition, cabin attendants wear BB-8 aprons.



SERVICE TO MEXICO

Houston has long enjoyed stronger connectivity with Mexico than any other U.S. airport. In 2016, that crucial bond became even stronger with new airlines introducing service within the Mexico market and existing carriers enhancing flight options for customers. With international air service returning to William P. Hobby Airport in October 2015, passengers in the Houston region now have two airports from which to choose for service to Mexico, and seven airlines connecting them to a total of 24 Mexican destinations.

SOUTHWEST INAUGURAL YEAR IN MEXICO

Southwest Airlines enjoyed an impressive year in regard to its domestic traffic at William P. Hobby Airport in 2016, but the biggest headlines were reserved for its performance in the international arena. After partnering with Houston Airports to open a new international concourse at Hobby Airport, the low-cost carrier operated nonstop flights to 10 different destinations in Latin America and the Caribbean, four of which are found in Mexico.

VOLARIS STARTS ROUTE TO MEXICO CITY

Low-cost Mexican airline Volaris announced the launch of nonstop service between Mexico City and Houston in October. The new service begins in March 2017. Volaris plans to operate nonstop flights to both Mexico City and Guadalajara from William P. Hobby Airport.

UNITED CELEBRATES 50 YEARS OF HOUSTON-MEXICO SERVICE

United Airlines celebrated 50 years of nonstop air service between Houston and Mexico in 2016, harkening back to a time long before the United name represented the busiest air carrier in the city. Texas International Airlines, the predecessor of Continental Airlines, launched nonstop service to Mexico in 1966. Continental Airlines would eventually merge with United Airlines in 2010.

RELAXED BILATERAL AGREEMENT

Passengers in Houston could be in store for even more flight options to Mexico thanks to a new and improved bilateral agreement reached between the United States and Mexico. The bilateral agreement removes the limits stating how many carriers can operate from each side of a particular market. And while there are still some limitations to access, such as slot restrictions at individual airports, the new agreement allows both U.S. and Mexican carriers to fly any route between the two countries without limitations on the number of frequencies.





According to Skytrax, seven of the Skytrax-ranked top 10 airlines in the world serve George Bush Intercontinental Airport, including the top three in the 2016 Skytrax World Airline Awards ratings.

THE AIRLINES RANKED AS FOLLOWS:



1. Emirates



2. Qatar



3. Singapore Airlines



5. All Nippon Airways



7. Turkish Airways



8. EVA Air



10. Lufthansa

GEORGE BUSH INTERCONTINENTAL

AIRPORT



George Bush Intercontinental Airport (IAH) is one of the nation's busiest airport facilities, handling 42 million passengers on an annual basis. Serving as one of United Airlines' most active hubs in the United States, IAH has earned a well-deserved reputation as a key Latin America gateway and Houston's premier long-haul airport facility.



NEW TERMINAL C NORTH

The IAH Terminal Redevelopment Program (ITRP), the largest construction project in the history of the Houston Airport System, is currently underway at George Bush Intercontinental Airport. Valued at more than \$1 billion, ITRP calls for the construction of two new terminal facilities, along with a host of other vital improvements. The first new terminal under the ITRP banner is the new Terminal C North, an 11-gate facility constructed through a partnership with United Airlines. Projected to open in the first quarter of 2017, the new terminal will offer passengers a spectacular view of the adjacent airfield through floor-to-ceiling windows, along with state-of-the-art amenities throughout the 265,000-square-foot facility.

A key aspect of the new terminal will be new shopping and dining options. The innovative in-terminal experience will include restaurants inspired by some of the region's most notable chefs, thousands of iPads equipped with an award-winning customer experience platform, farm-to-terminal offerings from local markets, and spaces designed from a modern and unique perspective.

IMPROVING THE EXPERIENCE





NEW MICKEY LELAND INTERNATIONAL TERMINAL (TERMINAL D)

Once the new Terminal C North is fully operational, then the path will be cleared for a new Mickey Leland International Terminal (also known as Terminal D). Plans call for the construction of a new 15-gate facility that is 53 percent larger than the existing Terminal D. That means the new terminal not only will cover the current footprint of the existing Terminal D but also will expand it dramatically.

The construction project will be phased to ensure no significant disruption to existing flight operations.

Step 1: New Terminal C North opens

Step 2: Foreign flag carriers, currently located in Terminal D, temporarily move into "old" Terminal C North

Step 3: Lobby and east wing of new Terminal D are constructed.

Step 4: "Old" Terminal C North is demolished and replaced with west wing of new Terminal D

INTERNATIONAL TRAVEL KEEPS RISING

The new Terminal D will especially facilitate the increase in international air travel occurring in Houston. Terminal D is home to all foreign flag carriers operating at George Bush Intercontinental Airport, a list that has grown substantially in recent years. Since 2006, many new international air carriers have established operations at IAH. During that time period, the number of passengers traveling aboard international flights has increased by 56 percent. The gains have been particularly strong to Asia (+201%), the Central/South American region (+77%), and Europe (+22%).

56



PERCENT
INCREASE

PASSENGERS TRAVELING ABOARD
INTERNATIONAL FLIGHTS

OPENING OF ECOPARK2

Drivers at George Bush Intercontinental Airport found more parking options than ever before throughout 2016, thanks in large part to the opening of the new ecopark2 parking lot. More than 2,300 new covered spaces were added to the Bush Airport parking inventory, with the new lot opening in time for the Memorial Day holiday rush.

The new ecopark2 location, at 5021 Will Clayton Boulevard, offers customers an affordable rate, along with charging stations for electric vehicles and access to a new fleet of environmentally friendly shuttle buses.

Combined with the spaces available at the ecopark location along John F. Kennedy Boulevard, nearly 11,000 parking spots will be available at the official on-airport value lots at Bush Intercontinental. About 4,000 of those are covered spaces. Along with the spaces available at the terminal garages, Bush Intercontinental customers have approximately 26,000 spaces to choose from at the airport.



NEW TECHNICAL OPERATIONS CENTER

On October 25, 2016, leaders from Houston Airports and United Airlines joined Houston Mayor Sylvester Turner in a ceremonial groundbreaking for a new United Airlines Technical Operations Center.

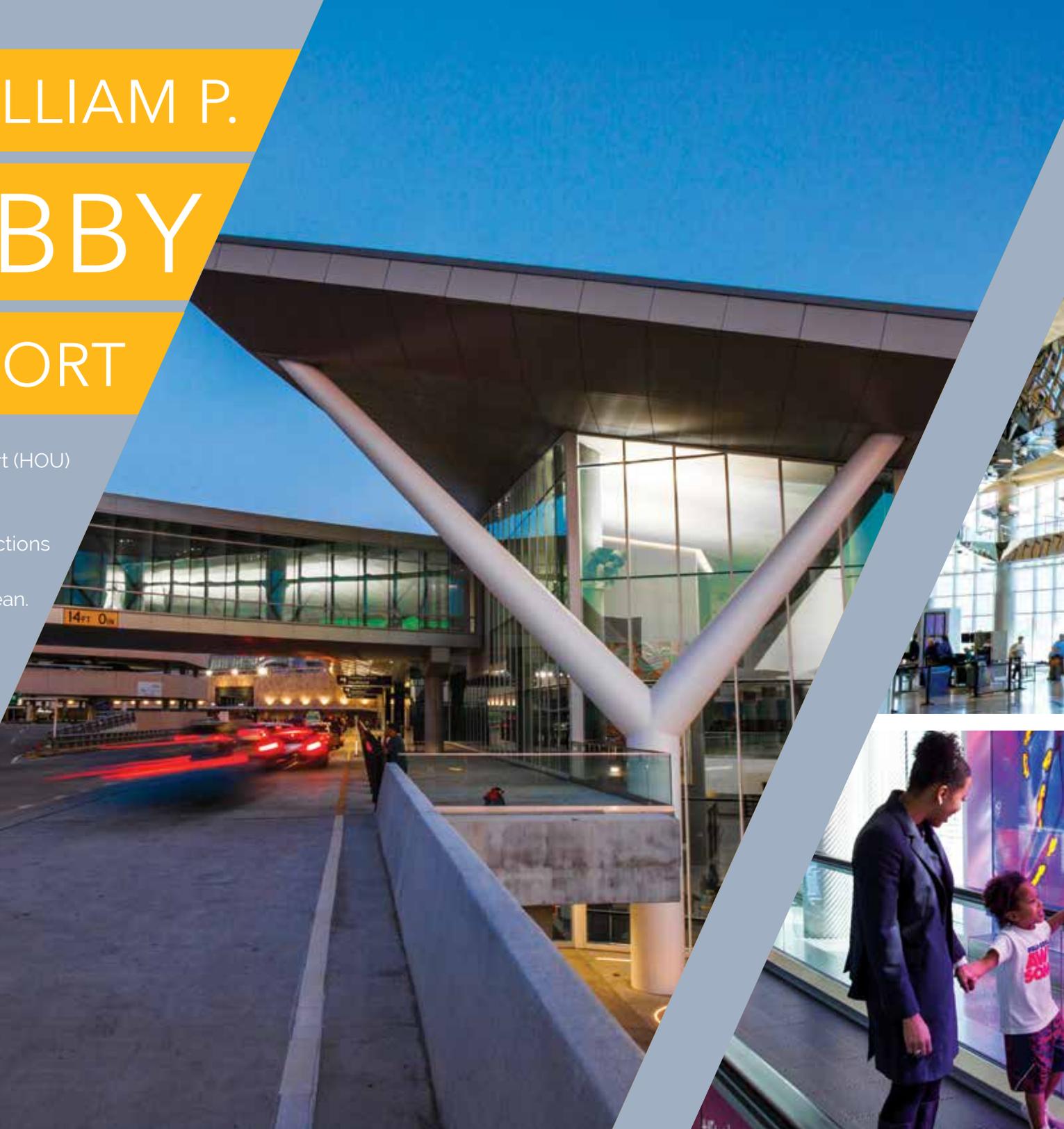
The project, which is the next phase of United's ongoing facilities expansion at its Houston hub, will add approximately 200,000 square feet of additional hangar capacity for widebody aircraft maintenance, a new warehouse distribution center, technical services building and administrative offices. In addition to accommodating widebody aircraft, including Boeing 767s, 777s, 787s and Airbus A350s, the \$162 million facility will provide an improved work environment with better ergonomics, safety and efficiency for United's maintenance technicians and support personnel.

200,000 SQ. FT. OF ADDITIONAL HANGAR CAPACITY



WILLIAM P. HOBBY AIRPORT

William P. Hobby Airport (HOU) is a convenient home to low-cost carriers, offering extensive domestic connections and international service to Latin America and the Caribbean.





A FOUR-STAR EXPERIENCE



SKYTRAX RATING

For several decades, William P. Hobby Airport has remained remarkably popular with its millions of customers for two key reasons: easy accessibility and a strong emphasis on customer service. Combine these two factors with the recent completion of a major expansion/renovation project and you begin to understand why Skytrax, a leading global air transport rating organization, gave Hobby Airport a 4-star rating for 2016. Hobby Airport is now one of only three airports in the United States to earn a 4-star rating from Skytrax.

Skytrax specifically cites the airport's convenient design as a major factor in the facility receiving this important recognition. Shorter walking distances, ample use of natural light and an impressive public art program also were mentioned as key contributors to the four-star rating.

The recognition is especially impressive when one considers the progress that has been made within the past decade. Since 2008, Hobby Airport has received a new ticketing lobby, baggage claim area, international concourse, parking garage and much more. Collectively, the improvements represent an investment valued at more than \$500 million.





ONE YEAR OF INTERNATIONAL SERVICE CELEBRATED

2016 proved to be a remarkably successful year for the return of international air service at William P. Hobby Airport. Regional international flights actually returned to Hobby Airport on October 15, 2015, after a 46-year hiatus that coincided with the opening of George Bush Intercontinental Airport in 1969. But the true test of overall success or failure would come in the ensuing months of 2016, as low-cost carrier Southwest Airlines expanded its international operation to 10 different cities throughout Latin America and the Caribbean.

By virtually any measure, the airline's international service is a success, with almost more than 800,000 people flying aboard international flights at Hobby Airport. In fact, Southwest Airlines' Mexico City – Houston route performed so well that the airline added a third daily frequency to its schedule on January 5, 2017.

Along with the arrival of expanded air service at Hobby Airport came a new \$150 million international concourse. The 280,000-square-foot building brought a host of customer enhancements, including a new ticketing lobby, new dining and shopping options, and a spacious facility for processing arriving international passengers.

ANOTHER RECORD-BREAKING YEAR

In addition to the impressive international passenger totals recorded in 2016, William P. Hobby Airport enjoyed yet another record-breaking year in regard to domestic traffic. For the first time in its history, Hobby Airport handled more than 12 million passengers traveling aboard domestic flights. This total was in addition to the 800,000 passengers traveling aboard international flights to and from Hobby Airport, which means that the facility processed approximately 13 million passengers during the calendar year. That total has never been equaled in the airport's eight-decade-plus history, representing an annual increase of nearly 7 percent over the previous year's total.

6.8 | PERCENT INCREASE
IN DOMESTIC TRAFFIC



THE NEW GARAGE ADDS 3,000 SPACES

NEW ROADWAY AND PARKING GARAGE

Besides spending the year enjoying a new international concourse and ticketing lobby, customers at William P. Hobby Airport also gained access to a new multi-level parking garage and extended bi-level roadway system.

The Houston Airport System opened the new 3,000-space "Blue Garage" just in time for the 2016 holiday rush, bringing drivers a convenient new parking option located immediately adjacent to the existing covered parking structure.

The new parking facility makes it incredibly easy for customers to find an open parking space by using a color-coded lighting system for each of its 3,000 spaces. Drivers simply look for the green light above an open space and make their way to it. The new garage brings the total number of parking spaces available at Hobby Airport to 6,500.

Drivers also are treated to a smoother and more spacious drive at Hobby Airport, especially for those dropping off departing passengers. Hobby's bi-level roadway system was completely remodeled, doubling the amount of space available for passenger drop-offs. The project also provided more lane space and an easier turning radius for drivers entering the Hobby Airport complex.

ELLINGTON

AIRPORT

Ellington Airport is the nation's tenth licensed commercial spaceport, and supports the operations of the United States military, NASA, and a variety of general aviation tenants.

The Houston Spaceport at Ellington Airport is the nation's first and only true urban spaceport facility, located just 20 miles south of the downtown Houston area. Houston Spaceport offers unprecedented access to a thriving aerospace community that includes Johnson Space Center and other NASA facilities. Coupled with a large industry of more than 80 aerospace companies, Houston Spaceport delivers unmatched advantages for its partners and tenants.





PHASE ONE DEVELOPMENT

Throughout 2016, significant steps were taken to move forward with a growth plan at Houston Spaceport known as Phase 1 development. This development plan spans 90 acres and creates a hub for innovation, education and commercial spaceflight.

A key component of this plan was the creation of the Houston Aerospace Support Center, the first dedicated infrastructure for the Houston Spaceport. The center offers 53,000 square feet of laboratory and office space. The co-working area includes an incubation space for early-stage companies, more permanent offices for developing companies, and larger facilities for companies that need room to mass produce their products.



By housing organizations from across a number of industries and disciplines on one campus, the Houston Spaceport will foster and accelerate key aerospace engineering activities, including:

- Component and composite development and fabrication
- Space vehicle assembly
- Zero-gravity scientific and medical experiments
- Microsatellite deployment
- Astronaut training and deployment
- Space tourism



With its investment in the aerospace industry's future — and in Houston's future — the Houston Spaceport won the Deal of the Year for 2015 at the inaugural Houston Business Journal Deals of the Year Awards. Selected from 47 finalists in a variety of categories, the Houston Spaceport also took the title in HBJ's Economic Development of the Year category.



NEW TOWER & TAXIWAY ARE ON THE WAY

Houston Spaceport, and the entire operation at Ellington Airport, will soon benefit from two key expansion and improvement programs. A new Federal Aviation Administration control tower and a taxiway are slated for construction alongside runway 4/22.

The new tower will include dedicated mission control facilities for commercial spaceflight operators, a first-of-its-kind advancement that will provide unique advantages for companies based at the spaceport. Parallel to runway 4/22, the new taxiway will give airside access to the spaceport's hangars and aprons, ultimately providing tenants with design-to-flight capabilities.



SPACECOM ENJOYS REMARKABLE "SOPHOMORE" YEAR

Houston Mayor Sylvester Turner was on hand to welcome more than 2,000 visitors from the U.S. and around the world to the second annual Space Commerce Conference and Exposition (SpaceCom) November 17-19 at the George R. Brown Convention Center.

The three-day conference explored business opportunities between space and terrestrial industries, with an emphasis on common technology challenges. Attendees explored ways to create and capitalize on new business opportunities. SpaceCom unites the commercial space industry to cohesively look for business opportunities and advancements.

SpaceCom is a partnership between Houston Airports, NASA's Johnson Space Center, the Greater Houston Convention and Visitors Bureau, Houston First Corp. and National Trade Productions, Inc.



The new tower will include dedicated mission control facilities for commercial spaceflight operators, a first-of-its-kind advancement that will provide unique advantages for companies based at the Houston Spaceport.

CELEBRATING HISTORY

Ellington Airport will celebrate its 100th year of existence throughout 2017, with festivities culminating in an open-to-the-public birthday bash on Saturday, May 20.

The Houston Airport System celebrated Ellington Airport's rich history in 2016 as well, as the airport made room for a key new tenant and hosted some of the more popular public events available in the nation's fourth-largest city.

LONE STAR FLIGHT MUSEUM

Construction on the new Lone Star Flight Museum took off in 2016, with a groundbreaking ceremony for the \$35 million project on July 7. The museum's board of directors decided to move the museum from Galveston to Ellington Airport after Hurricane Ike did significant damage in 2008. The new facility is now set to open its doors to the public in September 2017.

Dramatic progress was made throughout 2016, with construction moving forward on an aviation learning center and on a commemorative wing for the Texas Aviation Hall of Fame.

WINGS OVER HOUSTON & THE 9/11 HEROES RUN

Ellington Airport also continues to host some of the most popular public events that the city of Houston offers, including the Wings Over Houston Airshow and the 9/11 Heroes Run. The 2016 Wings Over Houston event attracted record-setting attendance totals, in part thanks to the U.S. Navy Blue Angels flight demonstration team. Meanwhile, the 9/11 Heroes Run once again attracted thousands of participants looking to honor the nation's heroes in uniform.



PARTNERSHIPS

While the Houston Airport System's primary focus is to connect the world to Houston through nonstop air service, all three airports find numerous other ways to support a wide variety of causes and events undertaken by the Houston community. In 2016, this supporting role ranged from welcoming world-class athletes to assisting young travelers with special needs.

SUPER BOWL LI

More than one million people passed through Houston's three airports during a six-day period before and after Super Bowl LI. George Bush Intercontinental Airport and William P. Hobby Airport helped create a welcoming ambiance for the flock of football fans, with everything from Super Bowl countdown clocks to informational signage and an army of red-shirted volunteers on hand to provide the personal touch to customer service. Ellington Airport ramped up operations to smoothly accommodate the increase in air traffic. On the Monday immediately following the game, nearly 190,000 passengers passed through the three airport facilities, with more than 70 percent of those departing. Ellington Airport alone handled 170 private aircraft departures. Inter-agency coordination, a well-organized plan and hundreds of volunteers helped the departure process go off without a fumble.

U.S. OLYMPIANS ARRIVE AND THE NCAA FINAL FOUR BASKETBALL TOURNAMENT

Without a doubt, the largest and most boisterous welcome home celebration of 2016 was reserved for Olympic gold medalist and hometown Houston hero Simone Biles. The gold-medal winning gymnast was met by Houston Mayor Sylvester Turner and hundreds of adoring fans after making her way back home from the 2016 Summer Olympic Games in Rio de Janeiro.

Houston Airports also rolled out the red carpet to welcome college basketball fans, when the 2016 NCAA Final Four tournament came to town in March. Once again, both Bush and Hobby Airports enjoyed their own shining moment, as tens of thousands of fans enjoyed a relaxed journey back home, thanks to an efficient and coordinated airport operation.





BREAST CANCER AWARENESS

Houston Airports put their support of National Breast Cancer Awareness Month on proud display in October 2016, when the entryway monument signs at George Bush Intercontinental Airport and William P. Hobby Airport were programmed to cast a pink hue. In addition to the lighting technique, Houston Airports staff and volunteers donned pink shirts — the official color for the movement — and took to the terminals to pass out pens and bracelets to help raise awareness about the need for early detection and the importance of taking preventive steps.



WINGS FOR ALL

Traveling can be a challenge for anyone, but the scope of those challenges can grow exponentially for individuals with intellectual and developmental disabilities. On April 26, 2016, the Houston Airport System teamed with advocate group The Arc, United Airlines, the Transportation Security Administration (TSA), The Arc of Fort Bend County, The Arc of Greater Houston, The Arc of Texas, and the Doug Flutie Foundation to offer the "Wings for All" special event at George Bush Intercontinental Airport. This unique program gives special needs travelers a chance to do a "dress rehearsal" as they prepare themselves for an actual nonstop flight. It was the third consecutive year that Houston Airports had participated in this important event.



WARRIORS WEEKEND

One of the most emotional events on the Houston Airports calendar is the Warriors Weekend send-off that occurs each year at George Bush Intercontinental Airport. Hundreds of wounded service members from the United States military pass through the airport on their way to a relaxing getaway weekend at Port O'Connor, Texas. Each year, hundreds of flag-waving well-wishers line the walkway as the wounded men and women make their way to an awaiting bus.



Houston is a globally connected city, both from an economic and a cultural standpoint. With the most diverse population base in the country and the nation's second-largest collection of Fortune 500 headquarters, Houston is a dynamic city that thrives on a welcoming spirit and can-do attitude. The Houston Airport System supports the city's strong global position, primarily through the operation of an extensive nonstop route map, but also by contributing in other ways, such as participating in global outreach efforts, communicating vital travel information to a global audience, facilitating dignitary arrivals, and accommodating an active conventions calendar promoted by the Greater Houston Convention & Visitors Bureau.

Working hand-in-hand with a variety of stakeholders, including U.S. Customs and Border Protection, the Transportation Security Administration and many others, the Houston Airport System looks to accommodate the travel needs of nearly 55 million passengers per year, along with the members of the nation's third-largest Consular Corps, which represents nearly 100 countries.

DELIVERING THE HOUSTON MESSAGE TO THE WORLD

In an effort to help communicate the "Houston Message" to a global audience, members of the Houston Airports team routinely take part in business outreach trips, traveling to virtually every corner of the globe alongside business groups such as the Greater Houston Partnership. In 2016, Houston Airports team members participated in trips to New Zealand, South Africa and the Middle East, as well as one of the most interesting destinations of the year — Havana, Cuba. Houston Airport System Director of Aviation Mario Diaz joined Houston Mayor Sylvester Turner and a 30-member delegation from Houston to explore the numerous partnership opportunities that may result from relaxed travel restrictions between the island nation and the United States. The trip marked the first time a Houston mayor had visited Cuba.

SPEAKING TO THE WORLD

Throughout 2016, Houston Airports handled nearly 1,500 separate requests from various news media outlets and generated more than \$50 million in positive media coverage. The number of people following the airport system through social media channels increased by almost 20 percent, with Bush and Hobby Airports currently boasting approximately 25,000 followers on Twitter alone. The newly revamped fly2houston.com website also is opening the door to new and creative ways of communicating vital information to the system's millions of customers.



25,000 FOLLOWERS ON TWITTER





SPECIAL EVENTS

One of the more diverse and demanding areas of the Houston Airports operation involves the team that's tasked with handling numerous special events. This all-encompassing area covers everything from celebratory events surrounding the launch of new air service to the coordination of musical entertainment during the holiday season. Volunteers are recruited and trained for major events such as Super Bowl LI, along with community-based efforts such as the "National Wreaths Across America Day" at Houston National Cemetery.

88TH ANNUAL AAAE CONFERENCE & EXHIBITION LANDED IN HOUSTON

Nearly 2,000 aviation business professionals traveled to Houston in May 2016 for the 88th Annual AAAE Conference & Exhibition. Mayor Sylvester Turner was on hand to welcome attendees during the opening ceremony. The conference featured lectures and training from some of the industry's most influential leaders, including TSA Administrator Pete Neffenger and Houston Aviation Director Mario Diaz.

VOLUNTEER AMBASSADORS PROVIDE PERSONAL TOUCH TO CUSTOMER SERVICE

One of the first impressions most visitors have of our city is when they step off an airplane at either George Bush Intercontinental Airport or William P. Hobby Airport. Something as simple as a friendly face to answer a question can make a confused traveler feel at home. The Houston Airport System Volunteer Ambassador Program is a vital part of the airport community because these ambassadors help enhance the customer experience for the nearly 55 million commercial passengers that pass through Houston airports annually.





AIRPORTS LAND TOP PRIZE IN RODEO PARADE

The Houston Livestock Show and Rodeo is Houston's premier event — drawing almost 2.5 million people — and the Houston Airport System made a splash with its first float in the annual parade through downtown. Airport staff dazzled paradegoers, designing and constructing a 20-foot float that featured a carriage pulling a large airplane with the airports' connection message. The hard work paid off because The Houston Airports' float received the parade's Sweepstakes award honoring best in show. The float was part of the airports' annual participation. Every year, the Houston Airports Rangers participate in the Houston Livestock Show and Rodeo parade. For the month of March, both Bush and Hobby airports brought the rodeo to passengers, displaying nearly 200 works of art from past Rodeo Houston's School Art program winners. These students, Pre-K through 12th grade, showcase the culture, history and heritage of Texas.

HARMONY IN THE AIR

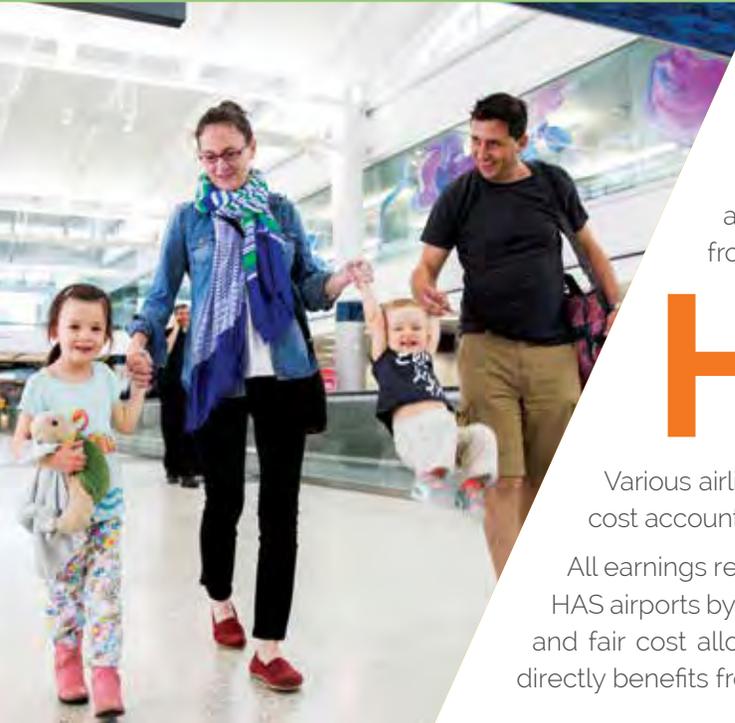
With enhancing the customer experience primarily in mind, Harmony in the Air continues to wow passengers visiting Houston's commercial airports. The performing arts program includes genres that reflect the rich culture of Houston — a diverse repertoire of classical, contemporary classical, smooth jazz and international music. Passengers continue to be amazed and delighted at the quality of music performances, as reflected in feedback collected via the website, comment cards in the terminals and social media. This free concert series is held at both airports, so please enjoy some of the city's best artists and musicians during your next trip.

FUNDING

THE FUTURE

The Houston Airport System is a self-sustaining department of the City of Houston, generating all revenues necessary to pay operating and maintenance expenses, debt service, and approximately \$70 million annually for reinvestment in its airport facilities. HAS levies no property or other taxes.





Airport revenues are categorized into two main groups: airline revenues (rates and charges paid by airlines for the use of terminal and airfield facilities) and non-airline revenues (parking fees, terminal concession privilege fees, rental car privilege fees, ground transportation privilege fees, and land and building rentals).

By federal law, airline rates and charges must be set to recover only properly allocated operating and capital costs. In this sense, airline revenues are cost recovery, and HAS cannot generate "profit" from these cost centers.

HAS IS A SELF-SUSTAINING DEPARTMENT OF THE CITY OF HOUSTON GENERATING MORE THAN \$600 MILLION IN ANNUAL REVENUE

Various airline use and lease agreements at IAH and HOU specify the rate-making principles, cost centers, and cost accounting methodologies that provide the basis for the rates and charges paid by the airlines at HAS.

All earnings retained by the airport enterprise are generated from non-airline revenues and must be reinvested in HAS airports by federal law. Any allocations of City expenses to HAS must be properly allocated under a transparent and fair cost allocation plan whereby HAS is charged as any other City department and only to the extent HAS directly benefits from the services provided by the City.



ANNUAL REVENUES

- Terminal rentals and use fees: 31%
- Parking and ground transportation: 18%
- Passenger facility charges: 17%
- Landing fees: 13%
- Terminal concessions: 6%
- Rental car concessions: 5%
- Land and building rentals: 4%
- Other: 6%

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

FINANCIAL HIGHLIGHTS

The Airport System Fund's net position increased by \$64.4 million or 5.0% during fiscal year 2016 and decreased by \$103.7 million or 7.5% during fiscal year 2015 due mostly to the cumulative effect of implementation of a new accounting principle.

In fiscal year 2016, operating income decreased \$18.2 million or 148.4% due to an increase in operating expenses of \$30.8 million or 6.6%. In fiscal year 2015, operating income increased \$20.2 million or 254.4% due to an increase in operating revenue of \$24.2 million or 5.3%.

Maintenance and operating expenses increased \$28.9 million or 10.1% in fiscal year 2016 and increased \$1.3 million or 0.5% in fiscal year 2015. Depreciation expense increased \$1.9 million or 1.1% in fiscal year 2016 and increased \$2.7 million or 1.5% in fiscal year 2015.

Investment income increased by \$5.8 million or 76.9% in fiscal year 2016 and decreased by \$3.7 million or 32.9% in fiscal year 2015.

The Fund had a net increase before capital contributions of \$41.9 million in fiscal year 2016, compared with a net increase before capital contributions of \$37.8 million in fiscal year 2015.

The Fund implemented Governmental Accounting Standards Board (GASB) Statement No. 68 at the start of fiscal year 2015, to record a net pension liability based not on the City's legal funding requirement, but on an actuarial calculation of total pension liability less the net position of the Houston Municipal Employee Pension System (HMEPS). This resulted in an unrestricted net position of \$(178.0) million as of June 30, 2016 and June 30, 2015.

The Fund made a voluntary change in accounting principle effective in fiscal year 2015, and is now including the assets, liabilities, revenues, expenses, net position, and additional notes of the Consolidated Rental Car Facility (CRCF) at George Bush Intercontinental Airport (IAH) in the Fund's comprehensive annual financial report.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Airport System Fund's financial statements. 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 (HAS), consisting of George Bush Intercontinental Airport (IAH), William P. Hobby Airport (HOU), and Ellington Airport (EFD), 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 statements of net position present information on all the Fund's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference between these sections reported as net position. Changes in net position 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 statements of revenues, expenses and changes in net position present information showing how the Fund's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The statements of cash flows report 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)

NET POSITION

Total net position at June 30, 2016 was \$1,345.8 million, a 5.0% increase from June 30, 2015.

Total net position at June 30, 2015 was \$1,281.4 million, a 7.5% decrease from June 30, 2014.

More than a third of the Fund's total net position (39.9% in fiscal year 2016; 36.4% in fiscal year 2015) reflects net investment in capital assets (e.g., land, buildings, runways, equipment and infrastructure), less any related outstanding debt used to acquire those assets. 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 Fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The other portions of the Fund's net position represent resources that are restricted and the unrestricted deficit. The restricted resources (73.3% in fiscal year 2016; 77.5% in fiscal year 2015) are subjected to external restrictions on how they may be used. Most of these restrictions are due to covenants made to the holders of the Fund's revenue bonds within ordinances passed by City Council. These covenants further require that any positive unrestricted net position carried in cash and cash equivalents at the end of the fiscal year be restricted for future capital improvements. The unrestricted net position remained at \$(178 million) due to the change from net pension obligation to net pension liability required by the Government Accounting Standards Board in Statement No. 68.

NET POSITION June 30, 2016, June 30, 2015, and June 30, 2014 (in thousands)

	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>June 30, 2014</u>
Assets			
Current assets	\$ 445,841	\$ 379,126	\$ 336,278
Noncurrent assets	854,870	881,893	831,733
Net capital assets	<u>2,958,464</u>	<u>2,918,004</u>	<u>2,861,794</u>
Total assets	<u>4,259,175</u>	<u>4,179,023</u>	<u>4,029,805</u>
Deferred Outflows of Resources	<u>59,367</u>	<u>43,490</u>	<u>35,973</u>
Liabilities			
Current liabilities	318,700	188,524	174,941
Long term liabilities	<u>2,651,555</u>	<u>2,750,775</u>	<u>2,505,729</u>
Total liabilities	<u>2,970,255</u>	<u>2,939,299</u>	<u>2,680,670</u>
Deferred Inflows of Resources	<u>2,526</u>	<u>1,847</u>	<u>-</u>
Net Position			
Net investment in capital assets	537,172	466,196	469,971
Restricted net assets	986,592	993,174	915,137
Unrestricted (deficit)	<u>(178,003)</u>	<u>(178,003)</u>	<u>-</u>
Total net position	<u>\$ 1,345,761</u>	<u>\$ 1,281,367</u>	<u>\$ 1,385,108</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

CHANGES IN NET POSITION

From July 1, 2015 to June 30, 2016, net position of the Airport System Fund increased by \$64.4 million or 5.0%.

From July 1, 2014 to June 30, 2015, net position of the Airport System Fund decreased by \$103.7 million or 7.5%.

Operating revenues increased by \$12.6 million or 2.6% for fiscal year 2016 and increased by \$24.2 million or 5.3% for fiscal year 2015. These changes in operating revenues compare with changes in total (enplaned and deplaned) system (IAH and HOU) passenger volume of positive 3.3% in fiscal year 2016 and positive 3.7% in fiscal year 2015. Operating revenue increases in fiscal year 2016 over fiscal year 2015 were primarily attributable to increases in non-airline revenues resulting from increases in parking fees and passenger volume.

For fiscal year 2016, total operating expenses increased \$30.8 million or 6.6%. Maintenance and operating expenses increased by \$28.9 million or 10.1% and depreciation increased by \$1.9 million or 1.1%.

For fiscal year 2015, total operating expenses increased \$4.0 million or 0.9%. Maintenance and operating expenses decreased by \$1.3 million or 0.5% and depreciation increased by \$2.7 million or 1.5%.

CHANGES IN NET POSITION Years Ended June 30, 2016, June 30, 2015, and June 30, 2014 (in thousands)

	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>June 30, 2014</u>
Operating revenue:			
Landing area fees	\$ 86,870	\$ 93,575	\$ 88,342
Rentals, building and ground areas	216,018	197,039	186,505
Parking and concessions	177,685	180,684	172,701
Other	<u>8,324</u>	<u>4,984</u>	<u>4,559</u>
Total operating revenues	<u>488,897</u>	<u>476,282</u>	<u>452,107</u>
Nonoperating revenue:			
Investment income (loss)	13,260	7,496	11,170
Passenger facility charges	104,230	85,392	62,602
Customer facility charges	16,417	17,535	17,152
Gain on disposal of assets	54	-	-
Other nonoperating	<u>70</u>	<u>7,969</u>	<u>3,225</u>
Total nonoperating revenues	<u>134,031</u>	<u>118,392</u>	<u>94,149</u>
Total revenues	<u>622,928</u>	<u>594,674</u>	<u>546,256</u>
Operating expenses:			
Maintenance and operating	315,419	286,529	285,212
Depreciation and amortization	<u>179,398</u>	<u>177,512</u>	<u>174,825</u>
Total operating expenses	<u>494,817</u>	<u>464,041</u>	<u>460,037</u>
Nonoperating expenses:			
Interest expense	86,212	89,999	94,183
Loss on disposal of assets	-	1,856	17,267
Special facility cost	<u>47</u>	<u>948</u>	<u>900</u>
Total nonoperating expenses	<u>86,259</u>	<u>92,803</u>	<u>112,350</u>
Total expenses	<u>581,076</u>	<u>556,844</u>	<u>572,387</u>
Excess (deficit) before contributions	41,852	37,830	(26,131)
Capital contributions	<u>22,542</u>	<u>36,432</u>	<u>44,614</u>
Change in net position	<u>64,394</u>	<u>74,262</u>	<u>18,483</u>
Beginning net position as previously reported	1,281,367	1,385,108	1,366,625
Cumulative effect of implementation of new accounting principle	-	(178,003)	-
Total net position, July 1	<u>1,281,367</u>	<u>1,207,105</u>	<u>1,366,625</u>
Total net position, June 30	<u>\$ 1,345,761</u>	<u>\$ 1,281,367</u>	<u>\$ 1,385,108</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Capital contributions are grant awards that are primarily related to reimbursements for expenses from construction projects. Amounts received from Federal Aviation Administration (FAA) discretionary, FAA entitlement and Transportation Security Administration (TSA) grants fluctuate year-to-year because of timing differences between the date of the award and the date of construction completion. In fiscal year 2016, capital contributions decreased \$13.9 million or 38.1% and in fiscal year 2015, capital contributions decreased \$8.2 million or 18.3%.

Non-operating revenue increased by \$15.6 million or 13.2% in fiscal year 2016, primarily due to an increase of \$18.8 million or 22% in passenger facility charge (PFC) collections. Non-operating revenue also increased by \$24.2 million or 25.7% in fiscal year 2015, primarily due to a \$22.8 million increase in passenger facility charges. On January 20, 2015, the FAA approved an amendment to the existing PFC at both IAH and HOU increasing the rate from \$3.00 per enplaned passenger to \$4.50 per enplaned passenger. The new rate was effective March 1, 2015. Investment income increased \$5.8 million or 76.9% in fiscal year 2016, due mostly to a \$3.7 million increase in the net unrealized fair value adjustments.

In fiscal year 2016, interest expense decreased by \$3.8 million or 4.2% because \$2.9 million more could be capitalized with eligible construction projects in fiscal year 2016 than in fiscal year 2015. In fiscal year 2015, interest expense decreased by \$4.2 million or 4.4% because of principal payments on various debt issues and the partial refunding of the Special Facility Revenue Bonds for the Consolidated Rental Car Facility Project, Series 2001.

CAPITAL ASSETS

The Airport System Fund's investment in capital assets amounts to \$5.63 billion at June 30, 2016, an increase of \$219.0 million, or 4.0%, from June 30, 2015. Capital assets at June 30, 2015 were \$5.41 billion, an increase of \$214.1 million, or 4.1%, from June 30, 2014.

CAPITAL ASSETS June 30, 2016, June 30, 2015, and June 30, 2014 (net accumulated depreciation in thousands)

	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>June 30, 2014</u>
Land	\$ 222,886	\$ 220,626	\$ 209,967
Rights & Intangibles - Non-Amortizable	9,752	9,387	8,371
Buildings and building improvements	2,900,383	2,703,195	2,672,949
Improvements other than buildings	2,072,292	2,009,275	1,973,443
Equipment	249,029	233,321	212,904
Rights & Intangibles - Amortizable	4,084	2,411	2,411
Construction work in progress	174,942	236,163	120,187
	<u>\$ 5,633,368</u>	<u>\$ 5,414,378</u>	<u>\$ 5,200,232</u>

At IAH, HAS is proceeding with the planning and procurement of design and construction support for the IAH Terminal Redevelopment Program (ITRP) which included the Mickey Leland International Terminal (MLIT), a new international terminal to replace the existing Terminal D on the current site of Terminals C-North and D as well as an expansion of the existing Central Federal Inspection Services (FIS) Facility with Terminal E. The new MLIT facility is anticipated to be completed in three major phases through 2023 and may include 15 widebody gates, compared with 6 in today's Terminal D, and includes related improvements to aircraft parking aprons and roadways. The terminal will be used by United Airlines and all foreign-flag airlines serving IAH and share the existing FIS Facility. The City awarded contracts for executive program manager and program management support services in fiscal year 2015 and anticipates awarding contracts for architectural and engineering, enabling, and support services in fiscal year 2017.

At HOU, capital improvements are planned for the airfield as required by the FAA as well as normal pavement management and customer service enhancements for the HOU Central Concourse. The international concourse opened in October 2015 as scheduled along with a variety of support projects including a satellite utility plant and improved roadway signage. A new parking garage provided 1,200 additional spaces at the opening of the new concourse. An additional 1,800 spaces were completed on June 30, 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

DEBT

At the end of the fiscal year, the Airport System Fund had total debt of \$2.5 billion, which represents outstanding senior and subordinate lien revenue bonds net of unamortized discounts and premiums, senior lien commercial paper, and an inferior lien contract, all secured solely by Airport System Fund revenues. In addition, the Fund is responsible for \$2.0 million of taxable general obligation pension bonds and \$96.9 million of special facility revenue bonds (consolidated rental car facility). At the end of fiscal years 2016 and 2015, the Fund had total debt of \$2.5 billion and \$2.4 billion, respectively.

Total outstanding debt increased \$74.7 million or 3.1% during fiscal year 2016, due to issuance of new commercial paper, retirement of existing debt, and the creation on October 15, 2015 of a note payable to Southwest Airlines for the construction of the Hobby International Terminal Project, with a balance on June 30, 2016 of \$120.4 million. Total outstanding debt decreased \$22.2 million or 0.9% during fiscal year 2015, due to issuance of the new commercial paper, retirement of existing debt, and a partial refunding of the special facility revenue bonds for the consolidated rental car facility project.

OUTSTANDING DEBT June 30, 2016, June 30, 2015, and June 30, 2014 (in thousands)

	June 30, 2016	June 30, 2015	June 30, 2014
Senior lien debt:			
Current maturities-revenue bonds	\$ 9,740	\$ 9,275	\$ -
Long-term revenue bonds payable	430,645	440,385	449,660
Unamortized discounts and premium	(603)	(737)	(878)
Commercial Paper	87,000	49,500	1,200
Total senior lien debt	526,782	498,423	449,982
Subordinate lien debt:			
Current maturities-revenue bonds	64,925	56,455	54,965
Long-term revenue bonds payable	1,579,765	1,644,690	1,701,145
Unamortized discounts and premium	65,705	72,562	79,577
Total subordinate lien debt	1,710,395	1,773,707	1,835,687
Inferior lien debt:			
Current maturities-contract	5,915	5,605	5,315
Long-term contract payable	6,240	12,155	17,760
Total inferior lien debt	12,155	17,760	23,075
Other debt:			
Current maturities-note payable	5,018	-	-
Long-term note payable	115,421	-	-
Pension obligation bonds	2,006	2,006	2,006
Special Facility Revenue Bonds -			
Consolidated Rental Car Facility:			
Current maturities	5,305	5,160	3,945
Long-term payable	91,590	96,895	101,485
Total other debt	219,340	104,061	107,436
Total outstanding debt	\$ 2,468,672	\$ 2,393,951	\$ 2,416,180
Deferred outflows of resources:			
Deferred outflows from refunding of debt	\$ (30,154)	\$ (33,044)	\$ (35,973)

The underlying ratings of the Airport System Fund's obligations for fiscal year 2016:

	As of June 30, 2016		
	Senior Lien	Subordinate Lien	Consolidated Rental Car SFRB
Fitch's Bond Rating	Not Rated	A	A-
Moody's Bond Rating	Aa3	A1	A3
Standard & Poor's Bond Rating	AA-	A+	A-

STATEMENTS OF NET POSITION AS OF JUNE 30, 2016 AND JUNE 30, 2015

(IN THOUSANDS)

	<u>2016</u>	<u>2015</u>
Assets		
Current assets		
Pooled cash and investment	\$ 389,416	\$ 336,484
Restricted cash and cash equivalents	5,541	5,514
Accounts Receivable (net of allowance for doubtful accounts of \$777 in 2016 and \$1,010 in 2015)	3,347	25,180
Due from City of Houston	31,833	873
Inventory	1,632	1,538
Prepays	2,817	2,894
Due from other governments - grants receivable	<u>11,255</u>	<u>6,643</u>
Total current assets	<u>445,841</u>	<u>379,126</u>
Noncurrent assets		
Pooled cash and investment	817,877	846,242
Restricted cash and cash equivalents	35,512	34,067
Prepays	1,481	1,584
Capital Assets		
Land	222,886	220,626
Intangibles	13,836	11,798
Buildings, improvements and equipment	5,221,704	4,945,791
Construction in progress	<u>174,942</u>	<u>236,163</u>
Total capital assets	5,633,368	5,414,378
Less accumulated depreciation and amortization	<u>(2,674,904)</u>	<u>(2,496,374)</u>
Net capital assets	<u>2,958,464</u>	<u>2,918,004</u>
Total noncurrent assets	<u>3,813,334</u>	<u>3,799,897</u>
Total assets	<u>4,259,175</u>	<u>4,179,023</u>
Deferred Outflows of Resources		
Deferred outflows from refunding of debt	30,154	33,044
Deferred outflows on pension liability	<u>29,213</u>	<u>10,446</u>
Total deferred outflows of resources	<u>\$ 59,367</u>	<u>\$ 43,490</u>

(continued)

STATEMENTS OF NET POSITION AS OF JUNE 30, 2016 AND JUNE 30, 2015

(IN THOUSANDS)

	<u>2016</u>	<u>2015</u>
Liabilities		
Current Liabilities		
Accounts payable	\$ 14,087	\$ 14,666
Accrued payroll liabilities	3,133	2,499
Due to City of Houston	970	361
Advances and deposits	2,082	1,980
Unearned revenue	1,922	1,974
Claims for workers' compensation	868	927
Compensated absences	5,945	5,570
Revenue bonds payable	74,665	65,730
Special facility revenue bonds payable	5,305	5,160
Inferior lien contract payable	5,915	5,605
Commercial paper payable	87,000	-
Note payable	5,018	-
Accrued interest payable	47,125	48,638
Contracts and retainages payable	64,665	35,414
Total current liabilities	<u>318,700</u>	<u>188,524</u>
Long-term liabilities		
Revenue bonds payable, net	2,075,512	2,156,900
Special facility revenue bonds payable	91,590	96,895
Inferior lien contract	6,240	12,155
Commercial paper payable	-	49,500
Pension obligation bonds payable	2,006	2,006
Note payable	115,421	-
Contract payable - Southwest Airlines	-	111,620
Claims for workers' compensation	937	1,210
Compensated absences	6,835	6,980
Net pension liability payable	282,811	248,348
Other post employment benefits	70,203	65,161
Total long-term liabilities	<u>2,651,555</u>	<u>2,750,775</u>
Total liabilities	<u>2,970,255</u>	<u>2,939,299</u>
Deferred Inflows of Resources		
Deferred inflows on pension liability	2,526	1,847
Total deferred inflows of resources	<u>2,526</u>	<u>1,847</u>
Net position		
Net Investment in capital assets	537,172	466,196
Restricted net position		
Restricted for debt service	333,635	303,371
Restricted for maintenance and operations	54,942	53,912
Restricted for special facility	26,944	25,732
Restricted for renewal and replacement	10,000	10,000
Restricted for capital improvements	561,071	600,159
Unrestricted (deficit)	(178,003)	(178,003)
Total net position	<u>\$ 1,345,761</u>	<u>\$ 1,281,367</u>

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

FOR YEARS ENDED JUNE 30, 2016 AND JUNE 30, 2015 (IN THOUSANDS)

	2016	2015
Operating Revenues		
Landing area fees	\$ 86,870	\$ 93,575
Rentals, building and ground area	216,018	197,039
Parking	101,650	97,515
Concessions	76,035	83,169
Other	8,324	4,984
Total operating revenues	488,897	476,282
Operating Expenses		
Maintenance and operating	315,419	286,529
Depreciation and amortization	179,398	177,512
Total operating expenses	494,817	464,041
Operating income (loss)	(5,920)	12,241
Nonoperating revenues (expenses)		
Investment income (loss)	13,260	7,496
Interest expense	(86,212)	(89,999)
Gain / (Loss) on disposal of assets	54	(1,856)
Passenger facility charges	104,230	85,392
Customer facility charges	16,417	17,535
Special facility cost	(47)	(948)
Other revenue	70	7,969
Total nonoperating revenues (expenses)	47,772	25,589
Income/(loss) before capital contributions	41,852	37,830
Capital contributions	22,542	36,432
Change in net position	64,394	74,262
Beginning net position as previously reported	1,281,367	1,385,108
Cumulative effect of implementation of new accounting principle	-	(178,003)
Total net position, July 1	1,281,367	1,207,105
Total net position, June 30	\$ 1,345,761	\$ 1,281,367

STATEMENTS OF CASH FLOWS FOR YEARS ENDED JUNE 30, 2016 AND JUNE 30, 2015

(IN THOUSANDS)

	2016	2015
Cash flows from operating activities		
Receipts from customers	\$ 504,457	\$ 469,062
Payments to employees	(101,054)	(99,326)
Payments to suppliers	(123,101)	(105,743)
Payments to the City of Houston	(94,776)	(57,553)
Claims paid	(868)	(928)
Other receipts	70	7,969
Net cash provided by operating activities	184,728	213,481
Cash flows from investing activities		
Sale of investments	1,687,735	1,945,584
Purchase of investments	(1,629,945)	(2,033,660)
Interest income (loss)	13,260	5,059
Net cash provided by (used for) investing activities	71,050	(83,017)
Cash flows from noncapital financing activities		
Interest expense for pension obligation bonds	(107)	(106)
Net cash provided by (used for) noncapital financing activities	(107)	(106)
Cash flows from capital and related financing activities		
Retirement of revenue bonds	(65,730)	(54,965)
Proceeds from issuance of special facility bonds	-	38,225
Refunding of special facility bonds	-	(37,245)
Proceeds from issuance of commercial paper	37,500	48,300
Interest expense on debt	(98,308)	(101,791)
Retirement of inferior lien contract	(5,605)	(5,315)
Retirement of special facility bonds	(5,160)	(4,355)
Passenger facility charges	105,154	75,572
Customer facility charges	16,640	17,540
Costs of issuing special facility bonds	-	(899)
Grant receipts	17,930	41,467
Acquisition of capital assets	(174,264)	(155,053)
Net cash provided by (used for) capital and related financing activities	(171,843)	(138,519)
Net increase (decrease) in cash and cash equivalents	83,828	(8,161)
Cash and cash equivalents, beginning of year	44,471	52,632
Cash and cash equivalents, end of the year	\$ 128,299	\$ 44,471
Current restricted - cash and cash equivalents	\$ 5,541	\$ 5,514
Noncurrent restricted - cash and cash equivalents	35,512	34,067
Pooled cash	87,246	4,890
Cash and cash equivalents, end of the year	\$ 128,299	\$ 44,471

(continued)

STATEMENTS OF CASH FLOWS FOR YEARS ENDED JUNE 30, 2016 AND JUNE 30, 2015

(IN THOUSANDS)

	2016	2015
Noncash transactions		
Capitalized interest expense	\$ 8,788	\$ 5,849
Capital additions included in note payable	120,440	-
Capital additions included in other liabilities	29,251	(957)
Grants included in receivables	4,612	(5,035)
Bond amortization expense	3,729	3,825
Gain/(loss) on disposal of assets	(129)	(1,410)
Total noncash transactions	\$ 166,691	\$ 2,272
Reconciliation of operating income (loss) to net cash used by operating activities:		
Operating income (loss)	\$ (5,920)	\$ 12,241
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Terminal space revenue-note payable	(5,153)	-
Depreciation	179,398	177,512
Capital improvement plan expense	4,616	2,720
Other receipts	70	7,969
Changes in assets and liabilities		
Accounts receivable	20,666	(7,012)
Due from the City of Houston	(30,960)	671
Inventory and prepaids	(16)	367
Accounts payable	(579)	4,404
Accrued payroll liabilities	634	340
Due to the City of Houston	609	47
Advances and deposits	48	(209)
Other post-employment benefits	5,042	4,716
Pension related payables and deferred amounts	16,375	9,758
Claims for workers' compensation	(332)	(547)
Compensated absences	230	504
Net cash provided by operating activities	\$ 184,728	\$ 213,481



The Houston Airport System provides a safe and dynamic air services network that fosters economic vitality for the transportation industry and facilitates a strong level of global connectivity for the diverse and growing population living throughout the greater Houston region.

Together, Houston Airports form one of North America's largest public airport systems and position Houston as the international passenger and cargo gateway to the south-central United States, as well as the primary gateway to Latin America.

HOUSTON AIRPORT SYSTEM

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