



2017 BUDGET LETTER

Originally constituted in 1911, the Port of Houston Authority (the “Authority”) is a political subdivision of the State of Texas and operates as a navigation district under Article XVI, Section 59 of the Texas Constitution. The Authority serves as the local sponsor of the Houston Ship Channel (the “Channel”), a federal waterway stretching 52 miles from the City of Houston to the Gulf of Mexico. The Authority’s boundaries are coterminous with Harris County.

The greater Port of Houston, which includes the Authority’s terminals and over 150 privately-held facilities along the Channel, is ranked first in the nation in foreign waterborne tonnage, first in U.S. import tonnage, first in U.S. export tonnage and second in the U.S. in total tonnage. Commercial activity through the Port of Houston is the primary factor for the Houston metropolitan area surpassing the New York metropolitan area as the nation’s largest export market since 2012, and also contributes to Texas being the nation's top exporting state for 14 consecutive years.

The Authority’s mission is “to move the world and drive regional prosperity.” This includes the promotion of sustainable trade and commerce to create jobs and economic development for the local region, Texas, and the nation. Management considers transparency, fiscally sound business practices, and prudent evaluation of risks and opportunities to be necessary elements for achieving such goals. In addition, a greater focus on financial planning and liquidity management is considered essential, in light of significant infrastructure investments required in the next few years. Expense management and creating operating efficiencies also continue as major objectives for the Authority.

In accordance with statutory requirements specified in Chapter 5007, Texas Special District Local Laws Code, the Port Commission, as the governing body of the Authority, approves an annual budget and a one-year capital plan. The Authority also develops a five-year forecast and a long-range plan addressing goals, strategies and priorities.

The Authority’s budget presentations and other materials are posted on its website (<http://porthouston.com>) in compliance with the statutes, and in line with the Authority’s commitment to financial transparency and its participation in the Texas Comptroller Transparency Stars program.

Operating Budget

A proposed 2017 operating and capital budget was developed to guide staff in the operation and management of Authority facilities and activities for Fiscal Year 2017. It was presented to the Port Commission for discussion at an open meeting on November 15, 2016, and approved on that date.

From a sustainability perspective, the Authority's operating revenues, derived primarily from tariffs related to its vessel and cargo activities, dredge material agreements and lease revenues, have generally been sufficient to cover its operating and maintenance costs. The Authority expects to generate annual cash flows ranging from \$132 million to \$172 million per annum over the next several years. Such excess cash is reinvested in the Authority's capital infrastructure.

In order to make the budget numbers understandable to the general public, the budget presentations posted on the Authority's website include additional narrative on cargo volume assumptions, detail of major changes in revenues and expenses (e.g., increases in terminal maintenance costs and depreciation resulting from investments in equipment and capital assets, etc.), as well as information on the Authority's budgeted expenditures for promotion and development in compliance with State statutes.

Shown below are highlights of the 2017 operating budget, compared to 2016 (in millions):

	<u>2016 Budget</u>	<u>2017 Budget</u>
Operating Revenues	\$ 295.9	\$ 311.9
Non-operating Revenues*	<u>5.6</u>	<u>11.3</u>
Total Revenues	\$ 301.5	\$ 323.2
Total Expenses	<u>246.7</u>	<u>266.1</u>
Net Income	<u>\$ 54.8</u>	<u>\$ 57.1</u>
Cash Flow	\$ 123.4	\$ 132.2

* Consists primarily of federal grants, insurance claims, and interest income.

For 2017, the Authority budgeted total operating revenues of \$311.9 million. This represents a 5% increase over the 2016 budget of \$295.9 million, reflecting growth in container volumes and general cargo, with a slight increase in steel imports. Non-operating revenues in 2017 reflect an expected increase in federal grant reimbursements.

Total expenses are budgeted at \$266.1 million, an increase of 8% versus the prior year, due primarily to higher terminal operating costs, depreciation and amortization, labor costs, asset maintenance, and general and administrative expenses.

Excluding revenues and expenses related to property taxes (see the next section on “Tax Revenues and Debt Service”), the Authority projects net income of \$57.1 million for 2017, an increase of 4% compared to the 2016 budget.

Tax Revenues and Debt Service

It should be noted that the operating budget does not include tax revenues. As the Authority’s ad valorem tax bonds were approved by Harris County voters at duly-called bond elections, the Authority works closely with the county on an annual basis to ensure that sufficient taxes are levied to cover the principal and interest debt service payments due on the Authority’s outstanding bonds.

Net tax receipts, after payment of collection fees to the Harris County Tax Assessor-Collector, are deposited in a segregated account and the funds are used exclusively to meet such debt service requirements, which are approximately \$53.1 million for calendar year 2017. Information on the Authority’s outstanding debt is posted on the Authority’s website, including the official statements of bond issuances and details of annual debt service payments.

Capital Plan

In recent years, the local region and the State of Texas have experienced significant population growth and economic expansion, due to the business-friendly environment and the expansion of the petrochemical industry. Investments made by local taxpayers in the Authority’s facilities and areas along the Houston Ship Channel over the years also have contributed to economic growth, job creation and expansion of the county, region and state tax base.

In order to accommodate larger vessels and increased cargo demands in the next 10 to 20 years, the Authority must develop, expand and renew its facilities. Replacing aging infrastructure, such as the Barbours Cut Terminal which opened in 1977, with more modern equipment supports our legislative mandate to facilitate commerce, navigation and safe waterways.

As shown in the Five Year Plan posted on the Authority’s website, we estimate capital investments of almost \$1 billion will be required during the period 2017 through 2021. Over \$600 million of those capital expenditures are planned for infrastructure expansion at both container terminals, with another \$145 million for improvements at the general cargo and bulk terminals, and \$93 million for channel development. The balance is designated for projects relating to security, information technology, real estate and maintenance operations.

In July 2014, we commenced a dredging project in the Barbours Cut and Bayport channels, where we are increasing the operating depth by 5 feet (to match the 45-foot authorized depth of the Houston Ship Channel) and widening those channels to accommodate larger vessels. As the uncertain federal appropriation process was estimated to take over 10 years, the Authority is funding this \$80 million dredging project in its entirety to ensure there will be no lost opportunity for cargo through our Port and for the benefit of our region. The dredging at Barbours Cut has been completed, and the Bayport dredging should be completed in early 2017.

During 2016, the Authority invested \$152 million in capital improvements, funded from the Authority's general fund and from grant monies received from federal and other governmental programs. The proceeds from tax bonds issued in prior years have been fully expended.

The Authority's 2017 capital budget was approved by the Port Commission on November 15, 2016 for up to \$73 million for various infrastructure improvements (see the chart on Page 5). Approximately \$32 million will be allocated to the container terminals for continuing development of Bayport and modernization at Barbours Cut, while \$5 million is designated for channel development projects and another \$13 million relates to improvements at the general cargo and bulk terminals in the Turning Basin area. The remaining 2016 capital budget funds will be used for railroad improvements, port security, building renovations and information technology.

Although the capital plan may be approved as to maximum annual amount of capital expenditures, individual items exceeding \$50,000 (both operating expenditures and capital projects) will continue to be presented separately to the Port Commission for approval in accordance with statutory requirements.

Five Year Plan and Liquidity

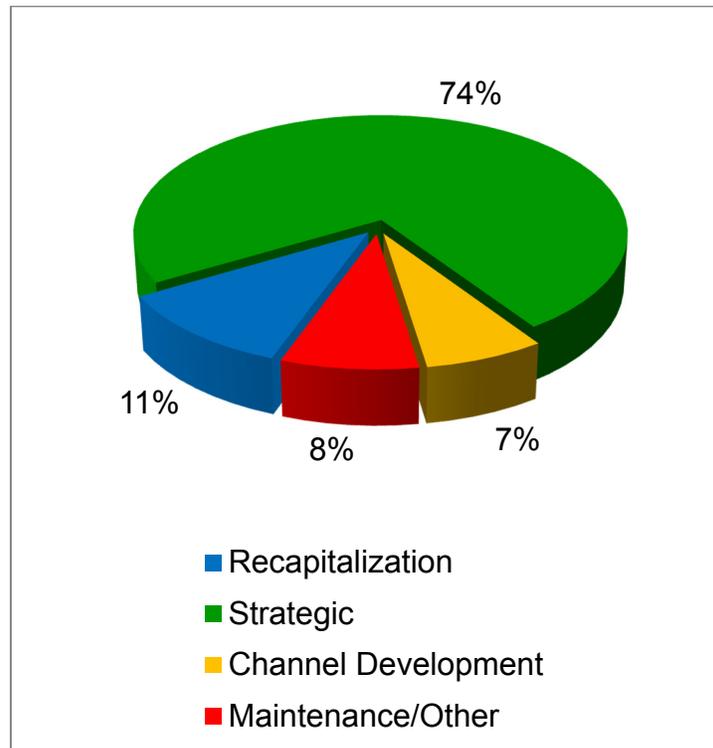
The Authority has estimated that capital improvements of about \$1 billion are required every five to seven years, in order to accommodate industry growth and continue to meet its mission for job creation and economic development.

As outlined in the Five Year Plan, despite strong operational and financial performance, the Authority is not able to fund such capital projects entirely from internally-generated cash flows. Additional financing is likely required in early 2018.

In the past, the Authority has relied on ad valorem tax bonds to help fund its capital infrastructure investments, but it may also consider interim financing alternatives to provide added liquidity in the next few years. As the capital improvement plan is implemented, the Authority will balance the infrastructure needs against available cash and funding resources to provide the greatest return on investment to the taxpayers in the form of jobs and economic growth.

2017 CAPITAL IMPROVEMENT PROGRAM

\$73 MILLION



- Recapitalization projects = \$8 million
 - *Investments required to sustain high service levels and/or enhance productivity*
- Strategic projects = \$54 million
 - *These investments support new growth opportunities*
- Channel projects = \$5 million
 - *Development at container terminals and DAMP areas*
- Remaining projects = \$6 million
 - *Includes required maintenance, equipment replacement, etc.*

Summary

The Authority has produced strong financial results in recent years. The budgeting and planning processes are designed to help the Port Commission and Authority staff, as stewards of the public trust, make informed decisions that enhance sustainability.

The economic impact of activities along the Houston Ship Channel is significant – \$265 billion annually and over 1.1 million jobs in Texas alone. These activities represent 16% of the State’s Gross Domestic Product. It is incumbent upon all stakeholders to ensure that this economic engine continues to produce jobs and economic development for the region, Texas and the nation.

Questions relating to the Authority’s budget and financial results may be submitted as a public information request by following the instructions on the Authority’s website (<http://porthouston.com/portweb/governance/public-information-requests/>).