# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PORT CONTROL
## DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND BURKE LAKEFRONT AIRPORTS

**REPORT ON AUDITS OF FINANCIAL STATEMENTS**
**For the years ended December 31, 2004 and 2003**

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PORT CONTROL
## DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL
## AND BURKE LAKEFRONT AIRPORTS

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**Auditor of State**
**Betty Montgomery**

## INDEPENDENT ACCOUNTANTS' REPORT

Divisions of Cleveland Hopkins International and
Burke Lakefront Airports
Department of Port Control
City of Cleveland
Cuyahoga County
601 Lakeside Avenue
Cleveland, Ohio 44114

To the Honorable Jane L. Campbell, Mayor, Members of Council, and the Audit Committee:

We have audited the accompanying financial statements of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports, Department of Port Control, City of Cleveland, Cuyahoga County, Ohio, as of and for the years ended December 31, 2004 and December 31, 2003, as listed in the table of contents. These financial statements are the responsibility of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports' 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. Those standards require that we plan and perform the audits to reasonably assure whether the financial statements are free of material misstatement. 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 opinions.

As discussed in Note A, the financial statements present only the Divisions of Cleveland Hopkins International and Burke Lakefront Airports, and do not purport to, and do not, present fairly the financial position of the City of Cleveland, Cuyahoga County, Ohio, as of December 31, 2004 and December 31, 2003, and the changes in its financial position and 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 Divisions of Cleveland Hopkins International and Burke Lakefront Airports as of December 31, 2004 and December 31, 2003, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis is not a required part of the basic financial statements but is supplementary information accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measuring and presenting the required supplementary information. However, we did not audit the information and express no opinion on it.

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We performed our audits to form an opinion on the financial statements of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports taken as a whole. The Schedule of Airport Revenue and Operating Expenses as defined in the Airline Use Agreement for the year ended December 31, 2004 is presented for purposes of additional analysis and is not a required part of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports' financial statements. Such information has been subjected to the auditing procedures applied in the audit of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports' financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the Divisions of Cleveland Hopkins International and Burke Lakefront Airports' financial statements taken as a whole.

Betty Montgomery

**Betty Montgomery**
Auditor of State

May 31, 2005

# CITY OF CLEVELAND, OHIO
# DEPARTMENT OF PORT CONTROL
# DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND BURKE LAKEFRONT AIRPORTS

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### GENERAL

As management of the City of Cleveland's (the "City") Department of Port Control, Divisions of Cleveland Hopkins International and Burke Lakefront Airports (the "Divisions"), we offer readers of the Divisions' financial statements this narrative overview and analysis of the financial activities of the Divisions for the year ended December 31, 2004. Please read this information in conjunction with the Divisions' basic financial statements and footnotes that begin on page 22.

The Divisions are charged with the administration and control of, among other facilities, the municipally owned airport facilities of the City. The Divisions operate a major public airport and a reliever airport serving not only the City of Cleveland, but also suburban municipalities in Cuyahoga, Medina, Summit and Geauga counties. In 2004, the Divisions were served by 27 scheduled airlines and 8 cargo airlines. In 2004, there were 117,000 scheduled landings with landed weight amounting to 8,074,843,000 pounds. There were 5,613,000 passengers enplaned at Cleveland Hopkins International Airport during 2004. In 2003, the Divisions were served by 23 scheduled airlines and 8 cargo airlines. In 2003, there were 111,000 scheduled landings with landed weight amounting to 7,827,776,000 pounds. There were 5,258,000 passengers enplaned at Cleveland Hopkins International Airport during 2003.

### COMPARISON OF 2004 DATA TO 2003 DATA

### FINANCIAL HIGHLIGHTS

- The assets of the Divisions exceeded its liabilities at December 31, 2004 by $389,149,000 (net assets). Of this amount, $110,141,000 (unrestricted net assets) may be used to meet the Divisions' ongoing obligations to customers and creditors.

- The Divisions' total net assets increased by $16,680,000 during 2004. This change is due to an increase in signatory landing fees, terminal rental rates and concession revenue offset by an increase in depreciation expense and an increase in interest expense.

- Additions to construction in progress totaled $110,998,000 in 2004. The principal capital expenditures during the year were for the construction of the second phase of the new runway and other associated projects such as the NASA relocation, which account for approximately 64.4% of the total expenditures. Approximately 8.9% was spent on the acquisition of property south of the Airport. Another 9.2% was spent on the rehabilitation of Concourse C, which is expected to be completed in 2006.

- The Divisions' total debt decreased by $11,104,000 during the current fiscal year. The key factor for this decrease was the payment of principal on the Series 1990, 1994 and 1997 Airport System Revenue Bonds (see Note B for additional information).

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Divisions' basic financial statements. The accompanying financial statements present financial information for the City of Cleveland's Divisions of Cleveland Hopkins International and Burke Lakefront Airports Fund, in which the City accounts for the operations of the Department of Port Control. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Divisions are considered an enterprise fund because the operations of the Divisions are similar to a private-sector business enterprise. Accordingly, in accounting for the activities of the Divisions, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Divisions can be found on pages 22-27 of this report.

The notes to the financial statements provide additional information that is essential to gain a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 29-45 of this report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Divisions as of December 31, 2004 and 2003:

| | 2004 | 2003 | Increase/ (Decrease) |
|---|---|---|---|
| | | (In thousands) | |
| Assets: | | | |
| Current assets | $ 92,282 | $ 87,033 | $ 5,249 |
| Restricted assets | 402,877 | 480,213 | (77,336) |
| Unamortized bond issuance costs | 13,523 | 14,420 | (897) |
| Capital assets, net | 918,298 | 847,385 | 70,913 |
| Total assets | $ 1,426,980 | $ 1,429,051 | $ (2,071) |
| Net assets and liabilities: | | | |
| Liabilities: | | | |
| Current liabilities | $ 74,466 | $ 82,942 | $ (8,476) |
| Long-term obligations | 963,365 | 973,640 | (10,275) |
| Total liabilities | 1,037,831 | 1,056,582 | (18,751) |
| Net assets: | | | |
| Invested in capital assets, net of related debt | (56,180) | (138,971) | 82,791 |
| Restricted for capital projects | 151,886 | 235,921 | (84,035) |
| Restricted for debt service | 117,005 | 122,349 | (5,344) |
| Restricted for passenger facility charges | 66,297 | 57,183 | 9,114 |
| Unrestricted | 110,141 | 95,987 | 14,154 |
| Total net assets | 389,149 | 372,469 | 16,680 |
| Total net assets and liabilities | $ 1,426,980 | $ 1,429,051 | $ (2,071) |

***Assets:*** Total assets remained fairly consistent between 2003 and 2004. The major decrease in restricted assets and increase in capital assets is due primarily to the cost of construction of the second phase of the new runway.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

***Capital assets:*** The Divisions' investment in capital assets as of December 31, 2004 amounted to $918,298,000 (net of accumulated depreciation). This investment in capital assets includes: land; land improvements; buildings, structures and improvements; furniture, fixtures and equipment; and construction in progress. The Divisions' investment in capital assets increased 8.4% in the current year. A summary of the activity in the Divisions' capital assets during the year ended December 31, 2004 is as follows:

| | Balance January 1, 2004 | Additions | Reductions | Balance December 31, 2004 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Land | $ 130,332 | $ 9,964 | $ | $ 140,296 |
| Land improvements | 360,702 | 281,431 | (38) | 642,095 |
| Buildings, structures and improvements | 402,088 | 8,058 | (637) | 409,509 |
| Furniture, fixtures, and equipment | 37,224 | 2,063 | | 39,287 |
| | 930,346 | 301,516 | (675) | 1,231,187 |
| Less: Accumulated depreciation | (292,505) | (40,018) | 608 | (331,915) |
| | 637,841 | 261,498 | (67) | 899,272 |
| Construction in progress | 209,544 | 110,998 | (301,516) | 19,026 |
| Capital assets, net | $ 847,385 | $ 372,496 | $ (301,583) | $ 918,298 |

Major events during the current fiscal year affecting the Divisions' capital assets included the following:

- Final construction of Runway 6L-24R was completed in 2004 with full Category III commissioning achieved on November 25, 2004. The commissioning of the runway was the culmination of a three-year construction project valued at $129,000,000. The runway was completed on schedule and on budget. The greater separation of the Runways 6L-24R and 6R-24L and the enhanced navigational aids for operating in poor weather will provide significant capacity and safety improvements for Cleveland Hopkins International Airport and the national airspace system. In order to construct Runway 6L-24R, several NASA research, support and ancillary facilities had to be relocated. The projects completed for an aggregate cost of $118 million over five years included construction at both NASA Glenn Research Center and NASA's Plumbrook Station near Sandusky. Additionally, the NASA projects also included the resolution of environmental concerns and the preparation of various items to document and preserve the history of the Altitude Combustion Stand, which was demolished to enable the runway to be constructed.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

- The Abram Creek Culvert project was completed in 2004 at a cost of $54,000,000. This three-year project included the installation of four parallel 10 ft. diameter culverts for a total length of approximately 3,600 liner feet. The project included culverting Abram Creek, filling a ravine with approximately 4 million cubic yards of earth, and construction of a central detention basin for storm water management for approximately 60% of the airport. Completion of the project was essential to the construction of Runway 6L-24R and the upcoming construction of the Runway 6R-24L Uncoupling and Extension. Additionally, the project provides for improved storm water management of runoff from the airport to prevent downstream flooding and improve water quality.

- Land south of the Cleveland Hopkins International Airport ("Hopkins Airport") was purchased in accordance with the settlement agreement between the City of Cleveland and the City of Brook Park. In 2004, the Divisions spent $9,964,000 on these properties. The Divisions plan on purchasing approximately 334 homes under this agreement.

- Additional information on the Divisions' capital assets, including commitments made for future capital expenditures, can be found in Notes A and F to the basic financial statements.

***Liabilities:*** Total liabilities decreased $18,751,000 due to a decrease in payables from restricted assets and a decrease in revenue bonds. The decrease in payables is due to the fact that there was less construction going on at Hopkins Airport at the end of 2004 due to the completion of phase two of the new runway in November of 2004.

***Long-term debt:*** At December 31, 2004, the Divisions had $966,788,000 in total debt outstanding. The Airport System Revenue Bonds are secured by the pledge of all airport revenues, as defined in the revenue bond indenture.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Divisions' debt obligations outstanding during the year ended December 31, 2004 is summarized below:

| | Balance January 1, 2004 | Debt Issued | Debt Refunded | Debt Retired | Balance December 31, 2004 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Airport System Revenue Bonds: | | | | | |
| Series 1990 | $ 8,487 | $ | $ | $ (3,044) | $ 5,443 |
| Series 1994 | 2,045 | | | (2,045) | |
| Series 1997 | 253,570 | | | (6,015) | 247,555 |
| Series 2000 | 573,190 | | | | 573,190 |
| Series 2003 | 140,600 | | | | 140,600 |
| Total | $ 977,892 | $ - | $ - | $ (11,104) | $ 966,788 |

The 2004 bond ratings for the Divisions' revenue bonds are as follows:

| Moody's Investors Service | Standard & Poor's |
|---|---|
| A3 | A- |

In 2003, Moody's removed the negative outlook on the Divisions' bond rating and reaffirmed the A3 rating. Standard & Poor's lowered the Divisions' rating from A to A- due to above average decline in passenger enplanements compared to national averages and an increased dependence on Continental Airlines as a hub carrier.

The ratio of net revenue available for debt service to debt service requirements (revenue bond coverage) is a useful indicator of the Divisions' debt position to management, customers and creditors. The Divisions' revenue bond coverage for 2004, 2003, and 2002, was 1.69%, 1.38%, and 1.33%, respectively.

Additional information on the Divisions' long-term debt can be found in Note B to the basic financial statements on pages 33-36.

***Net Assets:*** Net Assets serves as a useful indicator of an entity's financial position. In the case of the Divisions, assets exceed liabilities by $389,149,000 at the close of the most recent year.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

Of the Divisions' net assets, ($56,180,000) reflects its investment in capital assets (e.g., land, land improvement, buildings, machinery, and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Divisions use these capital assets to provide services to their customers. Consequently, these assets are not available for future spending. Although the Divisions' investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Divisions' net assets, $335,188,000 represents resources that are subject to external restrictions. These restricted net assets include proceeds from debt; amounts set aside in various fund accounts for payment of revenue bonds, which are limited by the bond indentures; unspent bond proceeds relating to capital projects; and Passenger Facility Charges imposed and collected at Cleveland Hopkins International Airport based on an approved Federal Aviation Administration application. Passenger Facility Charges are restricted for designated capital projects and approved debt service. The remaining balance of unrestricted net assets, $110,141,000 may be used to meet the Divisions' ongoing obligations to customers and creditors.

## CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION

The Divisions' operations increased its net assets by $16,680,000 in 2004 and decreased its net assets by $1,633,000 in 2003. Key elements of these changes are summarized below:

| | 2004 | 2003 | Increase/ (Decrease) |
|---|---|---|---|
| | | (In thousands) | |
| Operating revenues | | | |
| Landing fees | $ 37,203 | $ 31,370 | $ 5,833 |
| Terminal and concourse rentals | 43,123 | 36,842 | 6,281 |
| Concessions | 25,482 | 17,102 | 8,380 |
| Utility sales and other | 5,044 | 4,540 | 504 |
| Total operating revenues | 110,852 | 89,854 | 20,998 |
| Operating expenses | 98,665 | 91,606 | 7,059 |
| Operating income (loss) | 12,187 | (1,752) | 13,939 |
| Non-operating revenue (expense): | | | |
| Passenger facility charges revenue | 22,587 | 21,886 | 701 |
| Non-operating expense | (11,152) | (7,561) | 3,591 |
| Sound insulation program | (4,689) | (9,427) | (4,738) |
| Loss on disposal of capital asset | (68) | (13,592) | (13,524) |
| Interest income | 7,009 | 7,823 | (814) |
| Interest expense | (29,483) | (19,927) | 9,556 |
| Amortization of bond issuance expense, bond discounts and loss on debt refundings | (1,692) | (1,289) | 403 |
| Total non-operating revenue (expense), net | (17,488) | (22,087) | (4,599) |
| Capital and other contributions | 21,981 | 22,206 | (225) |
| Increase (decrease) in net assets | 16,680 | (1,633) | 18,313 |
| Net assets, beginning of year | 372,469 | 374,102 | (1,633) |
| Net assets, end of year | $ 389,149 | $ 372,469 | $ 16,680 |

## CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION (Continued)

***Operating revenues:*** In 2004 traffic increased at Hopkins Airport resulting in an increase in landed weight of 247,067,000 pounds, or 3.2% from last year. Of the $110,852,000 in total operating revenue, $33,802,000 or 30.5% was from signatory landing fees. This represents a 20.0% increase from 2003, which is primarily due to increased landing fee rate and increased traffic. Signatory terminal rentals accounted for $27,025,000 or 24.4% of total operating revenue. This represents an increase of 17.1%, which is primarily due to an increase in rates and charges. Parking operations accounted for $15,659,000 or 14.1% of the total operating revenues. This is an increase of 30.9% over the prior year's parking revenue. This increase is due to increased traffic at Hopkins Airport. Rental car revenues, the fourth largest revenue source accounted for 9.1% of total airport system revenues, representing an increase of 17.9% over the prior year.

***Operating expenses:*** Total operating expenses increased $7,059,000, due to an increase in depreciation expense and a slight increase in operations, maintenance and administrative expense. Depreciation expense increased due to the addition of phase two of the new runway, which opened in November of 2004.

***Non-operating revenue and expense:*** Expenses related to the Sound Insulation Program decreased by $4,738,000. The 2003 expenses were significantly higher due to the fact that in 2003 the program included insulation of St. Patrick's School. Loss on disposal of capital assets decreased $13,524,000 primarily due to the sale of property of the Divisions in 2003. This property was acquired under the Federal Noise Program and was not needed for future Hopkins Airport development. Interest expense increased $9,556,000 due to a decrease in the amount of interest that could be capitalized.

***Capital and other contributions:*** The Divisions received $21,981,000 in Federal Airport Improvement Grants. These grants were primarily for the residential sound insulation program, airfield safety improvements and the construction of runway 6L/24R.

## COMPARISON OF 2003 DATA TO 2002 DATA

## FINANCIAL HIGHLIGHTS

- The assets of the Divisions exceeded its liabilities at December 31, 2003 by $372,469,000 (net assets). Of this amount, $95,987,000 (unrestricted net assets) may be used to meet the Divisions' ongoing obligations to customers and creditors.

- The Divisions' total net assets decreased by $1,633,000 during 2003. This change is due to an increase in signatory landing fees and terminal rental rates which is offset by an increase in depreciation expense and a realized loss of $13,592,000 on the disposal of capital assets.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### FINANCIAL HIGHLIGHTS (Continued)

- During 2003, the Division's expenditures for capital improvements totaled $126,177,000. The principal capital expenditures during the year were for the construction of the second phase of the new runway and other associated projects such as the NASA relocation.

- The Divisions' total debt increased by $12,874,000 (1.3%) during the current fiscal year. The key factor in this increase was the sale of the 2003 Revenue Bonds, which were issued in order to refund the 1994 Revenue Bonds and retire the 2003 Surplus Revenue Note (see Note B for additional information).

### OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Divisions' basic financial statements. The accompanying financial statements present financial information for the City of Cleveland's Divisions of Cleveland Hopkins International and Burke Lakefront Airports Fund, in which the City accounts for the operations of the Department of Port Control. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Divisions are considered an enterprise fund because the operations of the Divisions are similar to a private-sector business enterprise. Accordingly, in accounting for the activities of the Divisions, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Divisions can be found on pages 22-27 of this report.

The notes to the financial statements provide additional information that is essential to gain a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 29-45 of this report.

## CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Divisions as of December 31, 2003 and 2002:

| | 2003 | 2002 | Increase/ (Decrease) |
|---|---|---|---|
| | | (In thousands) | |
| Assets: | | | |
| Current assets | $ 87,033 | $ 86,070 | $ 963 |
| Restricted assets | 480,213 | 567,123 | (86,910) |
| Unamortized bond issuance costs | 14,420 | 10,000 | 4,420 |
| Capital assets, net | 847,385 | 769,636 | 77,749 |
| Total assets | $ 1,429,051 | $ 1,432,829 | $ (3,778) |
| Net assets and liabilities: | | | |
| Liabilities: | | | |
| Current liabilities | $ 82,942 | $ 137,553 | $ (54,611) |
| Long-term obligations | 973,640 | 921,174 | 52,466 |
| Total liabilities | 1,056,582 | 1,058,727 | (2,145) |
| Net assets: | | | |
| Invested in capital assets, net of related debt | (138,971) | (208,207) | 69,236 |
| Restricted for capital projects | 235,921 | 332,618 | (96,697) |
| Restricted for debt service | 122,349 | 126,773 | (4,424) |
| Restricted for Passenger Facility Charges | 57,183 | 48,279 | 8,904 |
| Unrestricted | 95,987 | 74,639 | 21,348 |
| Total net assets | 372,469 | 374,102 | (1,633) |
| Total net assets and liabilities | $ 1,429,051 | $ 1,432,829 | $ (3,778) |

***Assets:*** Total assets remained fairly consistent between 2002 and 2003. The major decrease in restricted assets and increase in capital assets is due primarily to the cost of construction of the second phase of the new runway.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### CONDENSED BALANCE SHEET INFORMATION (Continued)

***Capital assets:*** The Divisions' investment in capital assets as of December 31, 2003 amounted to $847,385,000 (net of accumulated depreciation). This investment in capital assets includes: land; land improvements; buildings, structures and improvements; furniture, fixtures and equipment; and construction in progress. The Divisions' investment in capital assets increased 10.1% in the current year. A summary of the activity in the Divisions' capital assets during the year ended December 31, 2003 is as follows:

| | Balance January 1, 2003 | Additions | Reductions | Balance December 31, 2003 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Land | $ 143,538 | $ 930 | $ (14,136) | $ 130,332 |
| Land improvements | 353,018 | 8,857 | (1,173) | 360,702 |
| Buildings, structures and improvements | 371,938 | 30,150 | | 402,088 |
| Furniture, fixtures and equipment | 34,843 | 2,851 | (470) | 37,224 |
| | 903,337 | 42,788 | (15,779) | 930,346 |
| Less: Accumulated depreciation | (259,856) | (33,761) | 1,112 | (292,505) |
| | 643,481 | 9,027 | (14,667) | 637,841 |
| Construction in progress | 126,155 | 126,177 | (42,788) | 209,544 |
| Capital assets, net | $ 769,636 | $ 135,204 | $ (57,455) | $ 847,385 |

Major events during the current fiscal year affecting the Divisions' capital assets included the following:

- In October of 2003, Cleveland Hopkins International Airport opened a new 75,000 square foot consolidated maintenance facility costing $10,072,000. This facility houses the Airport's Field Maintenance Department including airfield equipment, service bays, storage areas, and a weld shop. Additional storage space for chemicals and bulk supplies is also located within the facility.

- Renovations were completed on the north end of the terminal baggage claim area. Approximately 15,000 square feet of new terminal space was added and 38,000 square feet of existing terminal space was renovated. The new construction included installation of two new baggage claim devices, additional restroom facilities, office space, and baggage make-up area. The renovation work included replacement of four existing baggage claim devices, renovation of existing central restroom facilities and conference room. In conjunction, with the baggage claim renovations, the airport rehabilitated the upper roadway located directly over the baggage claim area. Total cost of these renovations was $19,140,000.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

- Land located north of Hopkins Airport was sold in 2003. This land was acquired as part of the Federal Aviation Administration's Noise Program. This land was not needed for future Hopkins Airport development.

- Additional information on the Divisions' capital assets, including commitments made for future capital expenditures, can be found in Notes A and F to the basic financial statements.

***Liabilities:*** Total liabilities remained fairly consistent, however, current liabilities, including those payable from restricted assets, decreased $54,611,000 and long-term liabilities increased $52,466,000 due to the fact that the Divisions issued long-term debt and retired short-term debt (See Note B for additional information).

***Long-term debt:*** At December 31, 2003, the Divisions had $977,892,000 in total debt outstanding. The Airport System Revenue Bonds are secured by the pledge of all airport revenues, as defined in the revenue bond indenture.

The activity in the Divisions' debt obligations outstanding during the year ended December 31, 2003 is summarized below (excluding unamortized discounts, premiums and losses on debt refunding):

| | Balance January 1, 2003 | Debt Issued | Debt Refunded | Debt Retired | Balance December 31, 2003 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Airport System Revenue Bonds: | | | | | |
| Series 1990 | $ 12,198 | $ | $ | $ (3,711) | $ 8,487 |
| Series 1994 | 75,810 | | (71,860) | (1,905) | 2,045 |
| Series 1997 | 258,870 | | | (5,300) | 253,570 |
| Series 2000 | 573,190 | | | | 573,190 |
| Series 2003 | | 140,600 | | | 140,600 |
| Airport Surplus Revenue Notes | | | | | |
| Series 2001 | 44,950 | | | (44,950) | |
| Total | $ 965,018 | $ 140,600 | $ (71,860) | $ (55,866) | $ 977,892 |

## CONDENSED BALANCE SHEET INFORMATION (Continued)

The 2003 bond ratings for the Divisions' revenue bonds are as follows:

| Moody's Investors Service | Standard & Poor's |
|---|---|
| A3 | A- |

In 2003, Moody's removed the negative outlook on the Divisions' bond rating and reaffirmed the A3 rating. Standard & Poor's lowered the Divisions' rating from A to A- due to above average decline in passenger enplanements compared to national averages and an increased dependence on Continental Airlines as a hub carrier.

The ratio of net revenue available for debt service to debt service requirements (revenue bond coverage) is a useful indicator of the Divisions' debt position to management, customers and creditors. The Divisions' revenue bond coverage for 2003, 2002, and 2001 was 1.38%, 1.33%, and 1.44%, respectively.

Additional information on the Divisions' long-term debt can be found in Note B to the basic financial statements on pages 33-36.

***Net Assets:*** Net Assets serves as a useful indicator of an entity's financial position. In the case of the Divisions, assets exceed liabilities by $372,469,000 at the close of the most recent year.

Of the Divisions' net assets, ($138,971,000) reflects its investment in capital assets (e.g., land, land improvement, buildings, machinery and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Divisions use these capital assets to provide services to their customers. Consequently, these assets are not available for future spending. Although the Divisions' investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Divisions' net assets, $415,453,000 represents resources that are subject to external restrictions. These restricted net assets include proceeds from debt; amounts set aside in various fund accounts for payment of revenue bonds, which are limited by the bond indentures; unspent bond proceeds relating to capital projects; and Passenger Facility Charges imposed and collected at Cleveland Hopkins International Airport based on an approved Federal Aviation Administration application. Passenger Facility Charges are restricted for designated capital projects and approved debt service. The remaining balance of unrestricted net assets, $95,987,000 may be used to meet the Divisions' ongoing obligations to customers and creditors.

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

## CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION

The Divisions' operations decreased its net assets by $1,633,000 in 2003 and increased its net assets by $11,045,000 in 2002. Key elements of these changes are summarized below:

| | 2003 | 2002 | Increase/ (Decrease) |
|---|---|---|---|
| | | (In thousands) | |
| Operating revenues | | | |
| Landing fees | $ 31,370 | $ 28,544 | $ 2,826 |
| Terminal and concourse rentals | 36,842 | 34,163 | 2,679 |
| Concessions | 17,102 | 17,104 | (2) |
| Utility sales and other | 4,540 | 6,466 | (1,926) |
| Total operating revenues | 89,854 | 86,277 | 3,577 |
| Operating expenses | 91,606 | 86,777 | 4,829 |
| Operating income (loss) | (1,752) | (500) | 1,252 |
| Non-operating revenue (expense): | | | |
| Passenger facility charges revenue | 21,886 | 18,911 | 2,975 |
| Non-operating expense | (7,561) | (4,602) | 2,959 |
| Sound insulation program | (9,427) | (16,244) | (6,817) |
| Loss on disposal of capital asset | (13,592) | | 13,592 |
| Interest income | 7,823 | 9,895 | (2,072) |
| Interest expense | (19,927) | (22,630) | (2,703) |
| Amortization of bond issuance expense, bond discounts and loss on debt refundings | (1,289) | (1,174) | 115 |
| Total non-operating revenue (expense), net | (22,087) | (15,844) | 6,243 |
| Capital and other contributions | 22,206 | 27,389 | (5,183) |
| Increase (decrease) in net assets | (1,633) | 11,045 | (12,678) |
| Net assets, beginning of year | 374,102 | 363,057 | 11,045 |
| Net assets, end of year | $ 372,469 | $ 374,102 | $ (1,633) |

## CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION (Continued)

***Operating revenues:*** Due to changes within the transportation industry, airlines have begun to rely on smaller, more efficient jets to transport passengers. This has resulted in a decrease in landed weight of 366,305,000 pounds, or 5%, from last year. Of the $89,854,000 in total operating revenue, $28,177,000 or 31% was from signatory landing fees. This represents a 4% increase from 2002, which is primarily due to increased landing fee rate. Signatory terminal rentals accounted for $23,085,000 or 26% of total operating revenue. This represents an increase of 18%, which is primarily due to an increase in rates and charges. Parking operations accounted for 13% or $11,961,000 of the total operating revenues. This is an increase of 5% from 2002, which is due to a change in the parking rate structure and terms of the management contract. Rental car revenues, the fourth largest revenue source accounted for 10% of total airport system revenues, representing a decrease of 2% over prior year.

***Operating expenses:*** Total operating expenses increased $4,829,000, due to an increase in depreciation expense offset by a decrease in operations, maintenance and administrative expense. Depreciation expense increased due to a full year of depreciation on phase one of the new runway, which opened in December of 2002. The major decrease in operations, maintenance and administrative expense was due to the fact that, in 2002, the Divisions paid past due property taxes for a parcel that had been erroneously exempted. The Divisions have submitted a revised exemption request.

***Non-operating revenue and expense:*** Expenses related to the Sound Insulation Program decreased by $6,817,000. This is mainly due to the fact that, in 2002 the program included insulation of St. Patrick's School. Loss on disposal of capital assets increased $13,592,000 primarily due to the sale of property of the Divisions. This property was acquired under the Federal Noise Program and was not needed for future Hopkins Airport development. Revenue from Passenger Facility Charges increased $2,975,000, due to a full year of collections at the $4.50 level. Interest expense decreased $2,703,000 due to the payment of the first maturity on the 1990 Capital Appreciation Bonds in 2003.

***Capital and other contributions:*** The Divisions received $22,206,000 in Federal Airport Improvement Grants. These grants were primarily for the residential sound insulation program and the construction of runway 6L/24R.

## FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE FINANCIAL POSITION OR RESULTS OF OPERATIONS

Based on the current Master Lease and Use Agreement, which is residual in nature, the Divisions will adjust rates and charges to match expected expenditures.

## FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE FINANCIAL POSITION OR RESULTS OF OPERATIONS (Continued)

Hopkins Airport is currently renegotiating its Master Lease and Use Agreement, which expires on December 31, 2005. On October 1, 2004, the City signed a Memorandum of Understanding with Continental Airlines, Inc. to extend its lease agreement for 10 additional years at Cleveland Hopkins International Airport. With that agreement, Continental pledged continuation of its hub activities through 2015. The residual rate structure of Hopkins Airport will not change.

In the fall of 2005, Hopkins Airport will begin construction of a centralized deicing pad, thereby significantly reducing the amount of on-gate deicing operations at Hopkins Airport. This project will improve environmental compliance and work safety at Hopkins Airport.

Hopkins Airport will also begin construction of an extension to Runway 6R-24L. This extension will increase the runway length from 9,000 ft to 11,250 ft. and will allow for unrestricted, direct international service from Cleveland to any destination world-wide.

## ADDITIONAL INFORMATION

This financial report is designed to provide a general overview of the Divisions' finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Finance Director, City Hall, Room 104, 601 Lakeside Avenue, Cleveland, Ohio 44114.

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# BASIC FINANCIAL STATEMENTS

# CITY OF CLEVELAND, OHIO
# DEPARTMENT OF PORT CONTROL
# DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND BURKE LAKEFRONT AIRPORTS
## BALANCE SHEETS
### December 31, 2004 and December 2003

| | (In thousands) 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 11,511 | $ 11,965 |
| Restricted cash and cash equivalents | 11,736 | 20,055 |
| Investments | 53,053 | 42,319 |
| Receivables: | | |
| Accounts-net of allowance for doubtful accounts of $201,987 in 2004 and $112,932 in 2003 | 7,135 | 4,592 |
| Unbilled revenue | 4,399 | 5,913 |
| Landing fees - due from airlines | | 109 |
| Accrued interest receivable | 306 | 331 |
| Total receivables | 11,840 | 10,945 |
| Prepaid expenses | 653 | 634 |
| Due from other City of Cleveland departments, divisions or interfund accounts | 542 | 544 |
| Due from Federal government | 2,712 | 352 |
| Materials and supplies-at cost | 235 | 219 |
| **TOTAL CURRENT ASSETS** | 92,282 | 87,033 |
| **RESTRICTED ASSETS** | | |
| Cash and cash equivalents | 294,368 | 353,331 |
| Investments | 104,104 | 120,528 |
| Accrued interest receivable | 1,199 | 3,556 |
| Bond retirement reserve | 53 | 53 |
| Accrued passenger facility charges | 3,153 | 2,745 |
| **TOTAL RESTRICTED ASSETS** | 402,877 | 480,213 |
| **UNAMORTIZED BOND ISSUANCE COSTS** | 13,523 | 14,420 |
| **CAPITAL ASSETS** | | |
| Land | 140,296 | 130,332 |
| Land improvements | 642,095 | 360,702 |
| Buildings, structures and improvements | 409,509 | 402,088 |
| Furniture, fixtures, equipment | 39,287 | 37,224 |
| | 1,231,187 | 930,346 |
| Less: Accumulated depreciation | (331,915) | (292,505) |
| | 899,272 | 637,841 |
| Construction in progress | 19,026 | 209,544 |
| **CAPITAL ASSETS, NET** | 918,298 | 847,385 |
| **TOTAL ASSETS** | $ 1,426,980 | $ 1,429,051 |

(Continued)

**CITY OF CLEVELAND, OHIO**
**DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL**
**AND BURKE LAKEFRONT AIRPORTS**
**BALANCE SHEETS**
**December 31, 2004 and December 2003**

| | (In thousands) 2004 | 2003 |
|---|---|---|
| **LIABILITIES AND NET ASSETS** | | |
| **LIABILITIES** | | |
| **CURRENT LIABILITIES** | | |
| Current portion of long-term debt, due within one year | $ 9,373 | $ 11,104 |
| Current portion of long-term deferred payment obligation, due within one year | 1,741 | 1,612 |
| Accounts payable | 3,487 | 4,449 |
| Due to other City of Cleveland departments, divisions or interfund accounts | 1,483 | 1,637 |
| Current portion of accrued wages and benefits | 2,617 | 2,363 |
| Accrued interest payable | 32,754 | 35,438 |
| Accrued property taxes | 6,780 | 6,284 |
| Construction fund payable from restricted assets | 7,693 | 15,762 |
| Other construction accounts payable from restricted assets | 4,043 | 4,293 |
| Landing fee adjustment - payable to Airlines | 4,495 | |
| **TOTAL CURRENT LIABILITIES** | 74,466 | 82,942 |
| **LONG-TERM OBLIGATIONS -** excluding amounts due within one year | | |
| Revenue bonds | 942,249 | 950,826 |
| Deferred payment obligation | 20,307 | 22,047 |
| Accrued wages and benefits | 809 | 767 |
| **TOTAL LONG-TERM OBLIGATIONS** | 963,365 | 973,640 |
| **TOTAL LIABILITIES** | 1,037,831 | 1,056,582 |
| **NET ASSETS** | | |
| Invested in capital assets, net of related debt | (56,180) | (138,971) |
| Restricted for capital projects | 151,886 | 235,921 |
| Restricted for debt service | 117,005 | 122,349 |
| Restricted for passenger facility charges | 66,297 | 57,183 |
| Unrestricted | 110,141 | 95,987 |
| **TOTAL NET ASSETS** | 389,149 | 372,469 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 1,426,980 | $ 1,429,051 |

(Concluded)

See notes to financial statements.

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## CITY OF CLEVELAND, OHIO
## DEPARTMENT OF PORT CONTROL
## DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND BURKE LAKEFRONT AIRPORTS
## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
**For the Years Ended December 31, 2004 and December 2003**

| | (In thousands) | |
|---|---|---|
| | 2004 | 2003 |
| **OPERATING REVENUES** | | |
| Landing fees: | | |
| Scheduled airlines | $ 33,802 | $ 28,177 |
| Other | 3,401 | 3,193 |
| | 37,203 | 31,370 |
| Terminal and concourse rentals: | | |
| Scheduled airlines | 27,025 | 23,085 |
| Other | 16,098 | 13,757 |
| | 43,123 | 36,842 |
| Concessions | 25,482 | 17,102 |
| Utility sales and other | 5,044 | 4,540 |
| **TOTAL OPERATING REVENUES** | 110,852 | 89,854 |
| **OPERATING EXPENSES** | | |
| Operations, maintenance and administrative | 58,647 | 57,845 |
| Depreciation and amortization | 40,018 | 33,761 |
| **TOTAL OPERATING EXPENSES** | 98,665 | 91,606 |
| **OPERATING INCOME (LOSS)** | 12,187 | (1,752) |
| **NON-OPERATING REVENUE (EXPENSE)** | | |
| Passenger facility charges revenue | 22,587 | 21,886 |
| Non-operating expense | (11,152) | (7,561) |
| Sound insulation program | (4,689) | (9,427) |
| Loss on disposal of capital asset | (68) | (13,592) |
| Interest income | 7,009 | 7,823 |
| Interest expense | (29,483) | (19,927) |
| Amortization of bond issuance expense, bond discounts, and loss on debt refundings | (1,692) | (1,289) |
| **TOTAL NON-OPERATING REVENUE (EXPENSE) - NET** | (17,488) | (22,087) |
| **INCOME (LOSS) BEFORE CAPITAL AND OTHER CONTRIBUTIONS** | (5,301) | (23,839) |
| Capital and other contributions | 21,981 | 22,206 |
| **INCREASE (DECREASE) IN NET ASSETS** | 16,680 | (1,633) |
| **NET ASSETS, BEGINNING OF YEAR** | 372,469 | 374,102 |
| **NET ASSETS, END OF YEAR** | $ 389,149 | $ 372,469 |

See notes to financial statements.

**CITY OF CLEVELAND, OHIO**
**DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL**
**AND BURKE LAKEFRONT AIRPORTS**
**STATEMENTS OF CASH FLOWS**
**For the Years Ended December 31, 2004 and 2003**

| | (In thousands) 2004 | 2003 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Cash received from customers | $ 113,605 | $ 99,608 |
| Cash payments to suppliers for goods and services | (40,338) | (33,525) |
| Cash payments to employees for services | (21,383) | (21,215) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | 51,884 | 44,868 |
| **CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES** | | |
| Cash payments for sound insulation of homes | (5,043) | (10,239) |
| Cash payments for other non-operating costs | (939) | (1,624) |
| **NET CASH USED IN NON-CAPITAL FINANCING ACTIVITIES** | (5,982) | (11,863) |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Acquisition and construction of capital assets | (133,370) | (128,303) |
| Cash receipts for passenger facility charges | 22,435 | 20,794 |
| Proceeds from revenue bonds, net of costs and discount | | 135,293 |
| Proceeds from revenue notes, net of costs and discount | | 44,592 |
| Transfer to escrow agent for bond refunding | | (75,325) |
| Transfer to escrow agent for revenue note retirement | | (89,730) |
| Principal paid on long-term debt | (9,373) | (10,916) |
| Interest paid on long-term debt | (36,162) | (44,498) |
| Capital grant proceeds | 19,621 | 24,949 |
| **NET CASH PROVIDED BY (USED IN) CAPITAL AND RELATED FINANCING ACTIVITIES** | (136,849) | (123,144) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investment securities | (83,513) | (210,773) |
| Proceeds from sale and maturity of investment securities | 89,301 | 162,028 |
| Interest received on investments | 17,423 | 19,572 |
| **NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITES** | 23,211 | (29,173) |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | (67,736) | (119,312) |
| Cash and cash equivalents, beginning of year | 385,351 | 504,663 |
| Cash and cash equivalents, end of year | $ 317,615 | $ 385,351 |

(Continued)

**CITY OF CLEVELAND, OHIO**
**DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL**
**AND BURKE LAKEFRONT AIRPORTS**
**STATEMENTS OF CASH FLOWS (Reconciliation)**
**For the Years Ended December 31, 2004 and 2003**

| | (In thousands) | |
|---|---|---|
| | 2004 | 2003 |
| **RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES** | | |
| **OPERATING INCOME (LOSS)** | $ 12,187 | $ (1,752) |
| Adjustments to reconcile operating income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 40,018 | 33,761 |
| Non-cash rental income | (3,389) | (3,389) |
| Loss on disposal of equipment | 68 | |
| **Changes in assets and liabilities:** | | |
| Accounts receivable | (2,543) | 9,066 |
| Unbilled revenue | 1,514 | (3,177) |
| Landing fees - due from airlines | (109) | 6,486 |
| Prepaid expenses | (19) | (235) |
| Due from other City departments, divisions or funds | 2 | 1,721 |
| Materials and supplies, at cost | (16) | 14 |
| Accounts payable | (962) | 2,608 |
| Due to other City departments, divisions or funds | (154) | (912) |
| Accrued wages and benefits | 296 | 140 |
| Landing fees - due to airlines | 4,495 | |
| Accrued property taxes | 496 | 537 |
| **TOTAL ADJUSTMENTS** | 39,697 | 46,620 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | $ 51,884 | $ 44,868 |

(Concluded)

See notes to financial statements.

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**NOTES TO FINANCIAL STATEMENTS**
**For the Years Ended December 31, 2004 and 2003**

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Divisions of Cleveland Hopkins International and Burke Lakefront Airports (the "Divisions") are reported as an enterprise fund of the City of Cleveland Department of Port Control and are part of the City of Cleveland's (City) primary government. The Divisions were created for the purpose of operating the airports within the Cleveland metropolitan area. The following is a summary of the more significant accounting policies.

***Reporting Model and Basis of Accounting:*** The accounting policies and financial reporting practices of the Divisions comply with accounting principles generally accepted in the United States of America applicable to governmental units. Effective January 1, 2002, the Divisions changed their financial reporting by implementing the provisions of Statement No. 34 of the Governmental Accounting Standards Board (GASB), *Management's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These "Reporting Model" statements affect the way the Divisions prepare and present financial information. As a result of the implementation of these new GASB statements, the amount previously reported as the Divisions' equity is now reported as the Divisions' net assets in the accompanying balance sheets and the net assets are divided into four categories as follows:

- Amount invested in capital assets, net of related debt
- Amount restricted for capital projects
- Amount restricted for debt service
- Amount restricted for Passenger Facility Charges
- Remaining unrestricted amount

In addition, certain additional financial information regarding the Divisions is included in these footnotes. The implementation of the new GASB statements did not result in a change in the Divisions' beginning net asset/equity balance as previously reported.

***Basis of Accounting:*** The Divisions' financial statements are prepared under the accrual basis of accounting. Under this method, revenues are recognized when earned and measurable and expenses are recognized when incurred. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, all Proprietary Funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989. However, from that date forward, Proprietary Funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements) or 2) continuing to follow new FASB pronouncements (unless they conflict with GASB pronouncements). The City has chosen not to apply future FASB standards.

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

***Statement of Cash Flows:*** The Divisions utilize the direct method of reporting for the statement of cash flows as defined by the GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. In the statement of cash flows, cash receipts and cash payments are classified according to operating, non-capital financing, capital and related financing, and all investment activities.

***Cash and Cash Equivalents:*** Cash and cash equivalents represent cash on hand and cash deposits maintained by the City Treasurer on behalf of the Divisions. Cash equivalents are defined as highly liquid investments with a maturity of three months or less when purchased.

***Investments:*** The Divisions follow the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, which requires governmental entities to report certain investments at fair value in the balance sheet and recognize the corresponding change in the fair value of investments in the year in which the change occurred. The fair market value is based on quoted market values.

The City has invested funds in the State Treasurer Asset Reserve of Ohio (STAROhio) during 2004 and 2003. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on December 31, 2004 and 2003.

***Restricted Assets:*** Proceeds from debt and amounts set aside in various fund accounts for payment of revenue bonds are classified as restricted assets since their use is limited by the bond indentures.

***Restricted for Passenger Facility Charges:*** These assets are for Passenger Facility Charges imposed and collected at Cleveland Hopkins International Airport based on an approved Federal Aviation Administration application. These are restricted for designated capital projects or debt service.

***Capital Assets and Depreciation:*** Capital assets are stated on the basis of historical cost or, if contributed, at fair market value as of the date received. Depreciation is computed by allocating the cost of capital assets over the estimated useful lives of the assets using the straight-line method. A capital asset is defined as a tangible item with a useful life in excess of one year and an individual cost of more than $5,000 for furniture, fixtures and equipment and $10,000 for all other assets. When capital assets are disposed, the cost and related accumulated depreciation are removed from the accounts with gains or losses on disposition being reflected in operations. The estimated useful lives are as follows:

| | |
|---|---|
| Airfield (land improvements) | 3 to 75 years |
| Buildings, structures and improvements | 5 to 50 years |
| Furniture, fixtures and equipment | 3 to 35 years |

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Divisions' policy is to capitalize interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of the assets and is depreciated on the straight-line basis over the estimated useful lives of such assets. The Divisions apply Statement of Financial Accounting Standards No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants,* for its revenue bonds. This statement requires capitalization of interest cost of eligible borrowings less interest earned on investment of the related bond proceeds from the date of borrowing until the assets constructed from the bond proceeds are ready for their intended use.

For 2004 and 2003, total interest costs incurred amounted to $41,303,000 and $41,617,000, respectively, of which $5,639,000 and $9,825,000, respectively, was capitalized, net of interest income of $6,181,000 in 2004 and $11,865,000 in 2003.

***Bond Issuance Costs, Discounts and Unamortized Losses on Debt Refundings:*** Bond issuance expense is carried on the Divisions' books as a deferred expense and deferred bond discounts are netted against long-term debt. Both are amortized over the lives of the applicable bonds. Unamortized loss on debt refundings is netted against long-term debt and is amortized over the shorter of the defeased bond or the newly issued bond.

***Compensated Absences:*** The Divisions accrue for compensated absences such as vacation, sick leave and compensatory time using the termination payment method specified under GASB Statement No. 16, *Accounting for Compensated Absences*. These amounts are recorded as accrued wages and benefits in the accompanying balance sheets. The portion of the compensated absence liability that is not expected to be paid or utilized within one year is reported as a long-term liability.

Normally, all vacation time is to be taken in the year available. The Divisions allow employees to carryover vacation time from one year to the next with proper approval. Sick days not taken may be accumulated until retirement. An employee is paid one-third of accumulated sick leave upon retirement, calculated at three-year average base salary rate, with the balance being forfeited.

***Environmental Expenses:*** Environmental expenses consist of costs incurred for remediation efforts to airport property. Environmental expenses that relate to current operations are expensed or capitalized, as appropriate. Environmental expenses that relate to existing conditions caused by past operations and which do not contribute to future revenues are expensed. Liabilities are recorded when remedial efforts are probable and the costs can be reasonably estimated.

***Non-operating Expenses:*** Non-operating expenses relate to expenses of the Divisions incurred for purposes other than the operations of the airports and consist primarily of costs incurred for noise abatement for residents of communities surrounding Cleveland Hopkins International Airport. The funding for non-operating expenses is non-operating revenue (passenger facility charges, revenue bonds and federal grants).

***Interfund Transactions:*** During the course of normal operations, the Divisions have numerous transactions between other City divisions and departments. Unpaid amounts at year end are generally reflected as due to or due from in the accompanying financial statements.

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interfund receivables and payables balances at December 31, 2004 and 2003 are as follows:

| | 2004 Due From | 2004 Due To | 2003 Due From | 2003 Due To |
|---|---|---|---|---|
| | (In thousands) | | | |
| City of Cleveland General Fund | $ | $ 1,027 | $ | $ 535 |
| Division of Water Pollution Control | | 65 | | 65 |
| Division of Cleveland Public Power | | 44 | | 43 |
| Division of Research Planning & Development | 70 | | 60 | |
| Special Revenues - Transportation Fee | | | | 928 |
| Worker's Compensation Refund Reserve | 10 | 250 | | |
| Division of Radio Communication | | 11 | 15 | 6 |
| Division of Printing | 5 | | 12 | 1 |
| Division of Motor Vehicle Maintenance | | 52 | | 31 |
| Division of Telephone Exchange | 457 | 34 | 457 | 28 |
| | $ 542 | $ 1,483 | $ 544 | $ 1,637 |

## NOTE B - LONG-TERM OBLIGATIONS

Long-term debt outstanding at December 31 is as follows:

| | Interest Rate | Original Issuance | 2004 | 2003 |
|---|---|---|---|---|
| | | | (In thousands) | |
| Airport Expansion and Noise Mitigation Airport System Revenue Bonds: | | | | |
| Series 1990, due through 2006 | 7.15%-7.25% | $ 66,006 | $ 5,443 | $ 8,487 |
| Series 1994, due through 2004 | 5.4%-7.95% | 94,495 | | 2,045 |
| Series 1997, due through 2027 | 0.88%-7.00% | 277,165 | 247,555 | 253,570 |
| Series 2000, due through 2031 | 0.85%-5.50% | 573,190 | 573,190 | 573,190 |
| Series 2003, due through 2033 | Variable | 140,600 | 140,600 | 140,600 |
| | | $ 1,151,456 | 966,788 | 977,892 |
| Less: | | | | |
| Unamortized discount | | | (8,340) | (8,561) |
| Unamortized loss on debt refunding | | | (6,826) | (7,401) |
| Current portion (due within one year) | | | (9,373) | (11,104) |
| Total Long-Term Debt excluding the deferred payment obligation | | | $ 942,249 | $ 950,826 |

Summary: Changes in long-term obligations for the year ended December 31, 2004 are as follows:

| | Balance January 1, 2004 | Increase | Decrease | Balance December 31, 2004 | Due Within One Year |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Airport System Revenue Bonds | | | | | |
| Series 1990 | $ 8,487 | $ | $ (3,044) | $ 5,443 | $ 2,818 |
| Series 1994 | 2,045 | | (2,045) | | |
| Series 1997 | 253,570 | | (6,015) | 247,555 | 6,555 |
| Series 2000 | 573,190 | | | 573,190 | |
| Series 2003 | 140,600 | | | 140,600 | |
| Total revenue bonds | 977,892 | - | (11,104) | 966,788 | 9,373 |
| Accrued wages and benefits | 3,130 | 296 | | 3,426 | 2,617 |
| Total | $ 981,022 | $ 296 | $ (11,104) | $ 970,214 | $ 11,990 |

## NOTE B - LONG-TERM OBLIGATIONS (Continued)

Summary: Changes in long-term obligations for the year ended December 31, 2003 are as follows:

| | Balance January 1, 2003 | Increase | Decrease | Balance December 31, 2003 | Due Within One Year |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Airport System Revenue Bonds | | | | | |
| Series 1990 | $ 12,198 | $ | $ (3,711) | $ 8,487 | $ 3,044 |
| Series 1994 | 75,810 | | (73,765) | 2,045 | 2,045 |
| Series 1997 | 258,870 | | (5,300) | 253,570 | 6,015 |
| Series 2000 | 573,190 | | | 573,190 | |
| Series 2003 | | 140,600 | | 140,600 | |
| Airport Surplus Revenue Note | | | | | |
| Series 2001 | 44,950 | | (44,950) | | |
| Total revenue bonds & notes | 965,018 | 140,600 | (127,726) | 977,892 | 11,104 |
| Accrued wages and benefits | 2,912 | 218 | | 3,130 | 2,363 |
| Total | $ 967,930 | $ 140,818 | $ (127,726) | $ 981,022 | $ 13,467 |

Minimum principal and interest payments on long-term debt are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| | | (In thousands) | |
| 2005 | $ 9,373 | $ 54,142 | $ 63,515 |
| 2006 | 10,895 | 54,144 | 65,039 |
| 2007 | 17,775 | 47,894 | 65,669 |
| 2008 | 19,990 | 47,107 | 67,097 |
| 2009 | 20,880 | 45,805 | 66,685 |
| 2010-2014 | 122,935 | 211,499 | 334,434 |
| 2015-2019 | 159,490 | 175,136 | 334,626 |
| 2020-2024 | 205,985 | 128,373 | 334,358 |
| 2025-2029 | 264,615 | 69,461 | 334,076 |
| 2030-2034 | 134,850 | 7,636 | 142,486 |
| Total | $ 966,788 | $ 841,197 | $ 1,807,985 |

## NOTE B - LONG-TERM OBLIGATIONS (Continued)

Of the Airport System Revenue Bonds issued in 1990, $15,276,000 were issued in the form of Capital Appreciation Bonds. Interest on the Capital Appreciation Bonds is payable only as a component of their appreciated principal amount at maturity or redemption. Interest on the Capital Appreciation Bonds is compounded semiannually on each interest payment date beginning July 1990. As of December 31, 2004 and 2003, the Divisions have recorded a liability in the amount of $9,914,000 and $13,771,000, respectively, for compounded interest payable on the Capital Appreciation Bonds.

The Airport System Revenue Bonds are secured by the pledge of all airport revenues, as defined in the revenue bond indenture. Further, the City has assigned all its rights and interest in and to the airline use agreements to the Trustee under the revenue bond indenture. Amounts held in trust may be invested by the City Treasurer or the Trustee in permitted investments. However, the use of funds is limited by the bond indenture and, accordingly, are classified as restricted assets in these financial statements.

As of December 31, 2004, the Divisions were in compliance with the terms and requirements of the bond indenture.

The indenture, as amended, requires, among other things, that the Divisions (1) make equal monthly deposits to the Bond Service Fund to have sufficient assets available to meet debt service requirements on the next payment date; (2) maintain the Bond Service Reserve Fund equal in amount to the maximum annual debt service to be paid in any year; and (3) as long as any revenue bonds are outstanding, charge such rates, fees and charges for use of the Airport System to produce in each year, together with other available funds, net revenues (as defined) at least equal to the greater of (a) 116% of the annual debt service due in such year on all outstanding revenue bonds and general obligation debt or (b) 125% of the annual debt service due in such year on all outstanding bonds.

***Interest Rate Swap Transactions:***

Terms: Simultaneously with the issuance of the City's $140,600,000 Series 2003A-C Airport System Revenue Bonds on October 23, 2003 the City entered into floating-to-fixed rate swap agreements on the declining notional amount of the $20,650,000 Series A Bonds and the $56,200,000 Series B Bonds. Bear Stearns Financial Products Inc. is the counterparty on a five-eighths pro rata share of the notional amount of each Series while JPMorgan Chase Bank is the counterparty on the remaining three-eighths of the notional amount. Under the swap agreement for the Series 2003A Bonds, the Airport System will be the fixed rate payor, paying a fixed rate of 4.169% semiannually, while the Counterparties will pay the Airport System at the Bond Market Association index (BMA) every 35 days. The swap agreement for the Series 2003B Bonds requires the Airport System to pay a fixed rate of 4.273% semiannually and the Counterparties will pay the Airport System the BMA index plus 10 basis points every 35 days. The obligation of the Airport System to make periodic fixed rate payments (but not any termination payment) is secured by a pledge of Airport Revenues. Both the bond debt service payments and the periodic swap payments are insured by AMBAC.

## NOTE B - LONG-TERM OBLIGATIONS (Continued)

***Interest Rate Swap Transactions (Continued):***

Objective: The City entered into the swaps in order to minimize the costs associated with the refunding of the Series 1994A Bonds. Because all debt service charges of the Airport System are ultimately paid by the various airlines utilizing the City's airports, it was important to reduce the debt related costs as much as possible and the synthetic fixed rate debt provided the greatest debt service relief to the airlines.

Basis Risk: By entering into swaps based upon the BMA index, the City sought to minimize this risk. Since both the underlying bonds and the swap payments are based on the tax exempt market, any potential difference between the rate paid by the City on the bonds and the amount received by the City from the counterparties has been greatly reduced. The amount received on the 2003B Bonds incorporates an additional 10 basis points to take into account the fact that the underlying bonds are subject to the Alternative Minimum Tax.

Counterparty Risk: The City has selected highly rated counterparties in order to minimize this risk. However, over the long term it is possible that the credit strength of Bear Stearns and JPMorgan could change and this event could trigger a termination payment on the part of the City.

Termination Risk: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the City to Bear Stearns and JPMorgan, or by Bear Stearns and JPMorgan to the City, depending upon the prevailing economic circumstances at the time of the termination. The City obtained insurance to mitigate much of the risk associated with termination due to an event of downgrade of the City.

Fair Value: The fair value of the swaps at December 31, 2004 and December 31, 2003, as reported by JPMorgan Chase Bank was $1,136,000 and $739,213, respectively, for the Series 2003A and $3,134,000 and $2,023,091, respectively, for the Series 2003B which would be payable by the City to Bear Stearns and JPMorgan.

***Defeasance of Airport System Revenue Bonds:*** In prior years, the City defeased certain Airport System Revenue Bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the City's financial statements. The aggregate amount of defeased debt outstanding at December 31, 2004 and 2003 are as follows:

| Bond Issue | 2004 | 2003 |
|---|---|---|
| | (In thousands) | |
| Series 1994 | $ | $ 79,810 |

## NOTE C – SPECIAL FACILITY REVENUE BONDS

Airport Special Revenue Bonds, Series 1990, totaling $76,320,000 were issued to finance the acquisition and construction of a terminal, hangar and other support facilities of Continental Airlines at Cleveland Hopkins International Airport. These bonds were refunded in 1999 by the issuance of Airport Special Revenue Refunding Bonds, Series 1999, totaling $71,440,000. Airport Special Revenue Bonds, Series 1998, totaling $75,120,000 were issued in 1998 to finance the design and construction of certain airport facilities leased to Continental Airlines, including a new regional jet concourse.

Because all principal and interest on these bonds is unconditionally guaranteed by Continental Airlines and paid directly by Continental Airlines, these bonds do not constitute a debt, liability or general obligation of the City or a pledge of the Divisions' revenues. As such, no liabilities relating to these bonds are included in the accompanying financial statements.

## NOTE D – ACQUISITION OF INTERNATIONAL EXPOSITION CENTER

In January 1999, the City purchased the International Exposition (I-X) Center and the land on and around it for $66.5 million as part of its master plan to expand Cleveland Hopkins International Airport. As part of the purchase agreement, the City leased the building back to the former owner for 15 years, after which the City plans on tearing the building down to make way for airport development. Of the $66.5 million purchase price, $36.5 million was paid in cash in 1999. The remaining $30.0 million, including interest at 7.75%, is being deferred by the seller and will be offset by future lease payments owed to the City over the 15 year lease period. The future lease payments are equal to the remaining purchase price plus interest at 7.75%, and as such, no cash will be exchanged between the City and the lessee over the term of the lease. The deferred payment is reported as "Deferred Payment Obligation" in the accompanying balance sheet.

In the event that either a similar facility is developed that exceeds a specified size or there is an expansion of an existing facility that exceeds specified size within the municipal boundary of the City of Cleveland, the lessee has the right to terminate the lease. Such termination would require the City to pay the lessee the remaining portion of the deferred purchase price.

## NOTE D – ACQUISITION OF INTERNATIONAL EXPOSITION CENTER (Continued)

Minimum principal and interest payments due by the City on the deferred payment obligation and future minimum lease rentals due to the City under this lease for the next five years and thereafter are as follows:

| | Deferred Payment Obligation | | | |
|---|---|---|---|---|
| | **Principal** | **Interest** | **Total** | **Future Minimum Rentals** |
| | | (In thousands) | | |
| 2005 | $ 1,741 | $ 1,648 | $ 3,389 | $ 3,389 |
| 2006 | 1,881 | 1,508 | 3,389 | 3,389 |
| 2007 | 2,032 | 1,357 | 3,389 | 3,389 |
| 2008 | 2,195 | 1,194 | 3,389 | 3,389 |
| 2009 | 2,371 | 1,018 | 3,389 | 3,389 |
| Thereafter | 11,827 | 2,007 | 13,834 | 13,834 |
| | $ 22,047 | $ 8,732 | $ 30,779 | $ 30,779 |

Rental income recognized by the City under this agreement totaled $3,389,000 in 2004, of which $1,777,000 was offset against interest expense and $1,612,000 was offset against the principal balance of the deferred obligation.

## NOTE E – DEPOSITS AND INVESTMENTS

***Deposits:*** The Divisions' carrying amount of deposits at December 31, 2004 and 2003 totaled approximately $6,968,000 and $19,442,000, respectively, and the Divisions' bank balance was approximately $540,000 and $5,014,000, respectively. The difference represents normal reconciling items. Based on the criteria described in the GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements*, $504,000 and $5,014,000 of the bank balances were insured or collateralized with securities held by the City or by its agent in the City's name.

***Investments:*** The City's investment policies are governed by the state statutes and City Ordinances which authorize the City to invest in obligations of the U.S. Treasury, agencies and instrumentalities; bonds and other State of Ohio obligations; certificates of deposit; U.S. Government Money Market Mutual Funds; STAROhio; guaranteed investment contracts and repurchase transactions. Such repurchase transactions must be purchased from financial institutions or registered broker/dealers. Repurchase transactions are not to exceed a period of one year and confirmation of securities pledged must be obtained.

Under City policy, investments are limited to repurchase agreements, U.S. Government securities, certificates of deposit, investments in certain money market mutual funds, STAROhio, and guaranteed investment contracts. Generally, investments are recorded and are kept at the Federal Reserve Bank in the depository institutions' separate custodial account for the City, apart from the assets of the depository institution. Ohio statutes prohibit the use of Reverse Repurchase Agreements.

## NOTE E – DEPOSITS AND INVESTMENTS (Continued)

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements*, requires the City to categorize its investments into one of three credit risk categories:

***Category 1:*** Includes insured or registered, or securities held by the City or its agent in the City's name.

***Category 2:*** Includes uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.

***Category 3:*** Includes uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the City's name.

The categorized investments shown in the following table include those, which are classified as cash and cash equivalents in the balance sheet in accordance with the provisions of GASB Statement No. 9, since they have a maturity of three months or less:

| Type of Investment | Risk Category | 2004 Fair Value | 2004 Cost | 2003 Fair Value | 2003 Cost |
|---|---|---|---|---|---|
| | | (In thousands) | | | |
| U.S. Agency Obligations | 1 | $ 157,080 | $ 159,028 | $ 146,076 | $ 146,173 |
| U.S. Treasury Bills | 2 | 3,014 | 3,014 | 374 | 374 |
| U.S. Treasury Notes | 2 | | | | |
| STAROhio | n/a | 35,597 | 35,597 | 20,043 | 20,043 |
| Guaranteed Investment Contract | n/a | 127,682 | 127,682 | 197,839 | 197,839 |
| Investment in Mutual Funds | n/a | 2 | 2 | 16,345 | 16,345 |
| Other | n/a | 144,429 | 144,429 | 148,079 | 148,079 |
| Total Investments | | 467,804 | 469,752 | 528,756 | 528,853 |
| Total Deposits | | 6,968 | 6,968 | 19,442 | 19,442 |
| Total Deposits and Investments | | $ 474,772 | $ 476,720 | $ 548,198 | $ 548,295 |

STAROhio investments, guaranteed investment contracts, investments in mutual funds, and other investments are not classified by risk categories because they are not evidenced by securities that exist in physical or book entry form. Amounts represented by "Other" consist of deposits into a collective pool managed by JPMorgan, as trustee.

## NOTE F - CAPITAL ASSETS

***Capital Asset Activity:*** Capital Asset Activity for the year ended December 31, 2004 was as follows:

| | January 1, 2004 | Additions | Reductions | December 31, 2004 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Capital Assets, not being depreciated: | | | | |
| Land | $ 130,332 | $ 9,964 | $ | $ 140,296 |
| Construction in progress | 209,544 | 110,998 | (301,516) | 19,026 |
| Total capital assets, not being depreciated | 339,876 | 120,962 | (301,516) | 159,322 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 360,702 | 281,431 | (38) | 642,095 |
| Buildings, structures and improvements | 402,088 | 8,058 | (637) | 409,509 |
| Furniture, fixtures and equipment | 37,224 | 2,063 | | 39,287 |
| Total capital assets, being depreciated | 800,014 | 291,552 | (675) | 1,090,891 |
| Less: Total accumulated depreciation | (292,505) | (40,018) | 608 | (331,915) |
| Total capital assets being depreciated, net | 507,509 | 251,534 | (67) | 758,976 |
| Capital assets, net | $ 847,385 | $ 372,496 | $ (301,583) | $ 918,298 |

***Capital Asset Activity:*** Capital Asset Activity for the year ended December 31, 2003 was as follows:

| | January 1, 2003 | Additions | Reductions | December 31, 2003 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Capital Assets, not being depreciated: | | | | |
| Land | $ 143,538 | $ 930 | $ (14,136) | $ 130,332 |
| Construction in progress | 126,155 | 126,177 | (42,788) | 209,544 |
| Total capital assets, not being depreciated | 269,693 | 127,107 | (56,924) | 339,876 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 353,018 | 8,857 | (1,173) | 360,702 |
| Buildings, structures and improvements | 371,938 | 30,150 | | 402,088 |
| Furniture, fixtures and equipment | 34,843 | 2,851 | (470) | 37,224 |
| Total capital assets, being depreciated | 759,799 | 41,858 | (1,643) | 800,014 |
| Less: Total accumulated depreciation | (259,856) | (33,761) | 1,112 | (292,505) |
| Total capital assets being depreciated, net | 499,943 | 8,097 | (531) | 507,509 |
| Capital assets, net | $ 769,636 | $ 135,204 | $ (57,455) | $ 847,385 |

## NOTE F - CAPITAL ASSETS (Continued)

***Commitments:*** As of December 31, 2004 and 2003, the Divisions had capital expenditure purchase commitments outstanding of approximately $53,000,000 and $116,000,000, respectively.

## NOTE G – LEASES AND CONCESSIONS

The Divisions lease specific terminal and concourse areas to the various airlines under terms and conditions of the airline use agreements. These agreements will remain in effect until December 31, 2005 and, under the terms of the agreements, rental payments and landing fees paid by the airlines are adjusted annually to provide airport revenues sufficient to meet the financial requirements of the airport system. Other areas are leased to various occupants under separate agreements.

The Divisions have various concession agreements that permit the concessionaires and certain others to operate on airport property. These agreements usually provide for payments based on a percentage of the revenues, with an annual minimum payment guarantee and in certain circumstances for the offset of percentage rents to the extent of certain improvements made to the leased property.

Portions of the building costs in the balance sheet are held by the Divisions for the purpose of rental use. The net book value of property held for operating leases as of December 31, 2004 and 2003 is approximately $160,788,000 and $166,232,000, respectively.

Minimum future rental on non-cancelable operating leases to be received is as follows:

| | (In thousands) |
|---|---|
| 2005 | $10,406 |
| 2006 | 9,652 |
| 2007 | 8,893 |
| 2008 | 8,611 |
| 2009 | 2,138 |
| Thereafter | 8,660 |
| | $48,360 |

The Master Lease and Use Agreement, which leases space in the terminal building and other areas, are subject to fluctuating rates.

Contingent operating revenues aggregated approximately $20,894,000 and $17,626,000, respectively, in 2004 and 2003.

## NOTE H - CONTINGENT LIABILITIES AND RISK MANAGEMENT

***Contingent Liabilities:*** Various claims are pending against the City involving the Divisions for personal injuries, property damage and other matters. The City is responsible for the suits. The City's management is of the opinion that ultimate settlement of such claims will not result in a material adverse effect on the Divisions' financial position, results of operations or cash flows.

***Risk Management:*** The Divisions are exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Divisions carry insurance to cover particular liabilities and property protection. Otherwise, the Divisions are generally self-insured. No material losses, including incurred but not reported losses, occurred in 2004 or 2003. There was no significant decrease in any insurance coverage in 2004 or 2003. In addition, there were no material insurance settlements in excess of insurance coverage during the past three years.

The City provides the choice of four separate health insurance plans for its employees. These plans are provided by two different insurers through commercial insurance. Operating funds are charged a monthly rate per employee, by type of coverage. The City participates in the State of Ohio workers' compensation retrospective rating program.

In accordance with GASB Statement No. 10, claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are re-evaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The estimate of the claims liability also includes amounts for incremental claim adjustment expenses related to specific claims and other claim adjustment expenses, regardless of whether allocated to specific claims. Estimated recoveries, for example from salvage or subrogation, are another component of the claims liability estimate. Claims payable has been included with accounts payable and is considered to be immaterial for the Divisions.

## NOTE I - EMPLOYEES RETIREMENT PLAN

All full-time employees, other than non-administrative full-time police officers and firefighters, participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

1) The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan.
2) The Member-Directed Plan (MD) – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan members accumulate retirement assets equal to the value of member and (vested) employer contributions plus any investment earnings.
3) The Combined Plan (CO) – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, employer contributions are invested by OPERS to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension Plan and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. The Ohio Public Employees Retirement System issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-6701 or 1-800-222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. Member and employer contribution rates were consistent across all three plans (TP, MD and CO). Member contribution rates were 8.5% and employer contribution rates were 13.55% of covered payroll. The Divisions' required employer contributions to OPERS for all plans for the years ending December 31, 2004, 2003 and 2002 were approximately $2,182,000, $2,188,000 and $2,078,000 each year, respectively. The required payments due in 2004, 2003 and 2002 have been made.

## NOTE J - OTHER POST EMPLOYMENT BENEFITS

Ohio Public Employees Retirement System (OPERS) administers three separate pension plans: The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement, disability and survivor benefits as well as postretirement health care coverage to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. In order to qualify for postretirement health care coverage, age and service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS is considered to be an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12.

## NOTE J - OTHER POST EMPLOYMENT BENEFITS (Continued)

A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The Divisions' contribution rate was 13.55% of covered payroll, and 4.00% was used to fund health care for the year. The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS. The assumptions and calculations below were based on OPERS' latest actuarial review performed as of December 31, 2003. An entry age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually. The investment assumption rate for 2003 was 8.00%. An annual increase of 4.00%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from 0.50% to 6.30%.

Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1% to 6% for the next 8 years. In subsequent years (and beyond) health care costs were assumed to increase at 4% (the projected inflation rate). OPEBs are advance-funded on an actuarially determined basis. At year-end 2004, the number of active contributing participants in the Traditional and Combined Plans totaled 369,885. The employer contribution rates are the actuarially determined contribution requirements for OPERS. The Divisions' actual contributions for 2004 which were to fund postemployment benefits were approximately $644,000. $10.5 billion represents the actuarial value of OPERS' net assets available for OPEB at December 31, 2003. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were $26.9 billion and $16.4 billion, respectively.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures OPERS' health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Under the HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. The Plan incorporates a cafeteria approach, offering a broad range of health care options that allow benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a Retiree Medical Account that can be used to fund future health care expenses.

**NOTES TO FINANCIAL STATEMENTS (Continued)**
**For the Years Ended December 31, 2004 and 2003**

## NOTE K - RELATED PARTY TRANSACTIONS

The Divisions are provided various intra-city services. Charges are based on actual use or on a reasonable pro rata basis. The more significant costs for the years ended December 31, 2004 and 2003, were as follows:

| | 2004 | 2003 |
|---|---|---|
| | (In thousands) | |
| City Central Services, including police | $ 5,837 | $ 6,466 |
| Electricity purchased | $ 275 | $ 258 |
| Motor vehicle maintenance | $ 253 | $ 330 |

## NOTE L– LANDING FEE ADJUSTMENT AND INCENTIVE COMPENSATION

Under the terms of the airline use agreements, if the annual statement for the preceding term demonstrates that airport revenues over expenses (both as defined) is greater or less than that used in calculating the landing fee for the then current term, such difference shall be charged or credited to the airlines over the remaining billing periods in the current term. The landing fee adjustment for 2004 was a payable to the Airlines of $4,495,000. In 2003, the landing fee adjustment was a payable to the airport of $109,000.

The airline use agreements also provide an incentive for the City to provide the highest quality management for the airport system. There was no incentive compensation expense in 2004 and 2003.

## NOTE M – PASSENGER FACILITY CHARGES

On November 1, 1992, Cleveland Hopkins International Airport began collecting passenger facility charges (PFC's) subject to title 14, Code of Federal Regulations, Part 158. PFC's are fees imposed on passengers enplaned by public agencies controlling commercial service airports for the strict purpose of supporting airport planning and development projects. The charge is collected by the airlines and remitted to the airport operator net of an administrative fee to be retained by the airline and refunds to passengers. Under its federally approved program from inception in 1992 to 2007, the airport expects to collect approximately $287 million, of which an estimated 32% will be spent on noise abatement for the residents of communities surrounding the airport, 41% on runway expansion, and 27% on airport development. PFC revenues and related interest earnings are recorded as non-operating revenues, and non-capitalized expenses funded by PFC revenues are recorded as non-operating expenses.

## NOTE N – MAJOR CUSTOMER

In 2004 and 2003, operating revenues from one airline group for landing fees, rental and other charges amounted to approximately 34% and 36% respectively, of total operating revenue.

**CITY OF CLEVELAND**
**DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL**
**AND BURKE LAKEFRONT AIRPORTS**
**SCHEDULE OF AIRPORT REVENUES AND OPERATING EXPENSES**
**AS DEFINED IN THE AIRLINE USE AGREEMENTS**
**For the Year Ended December 31, 2004**

| | Cleveland Hopkins International | Burke Lakefront | Total |
|---|---|---|---|
| | | (In thousands) | |
| **REVENUE** | | | |
| Airline revenue: | | | |
| Landing fees | $ 33,802 | $ | $ 33,802 |
| Terminal rental | 27,025 | | 27,025 |
| Other | 2,705 | | 2,705 |
| | 63,532 | - | 63,532 |
| Operating revenues from other sources: | | | |
| Concessions | 25,141 | 341 | 25,482 |
| Rentals | 12,449 | 261 | 12,710 |
| Landing fees | 3,240 | 161 | 3,401 |
| Other | 4,880 | 164 | 5,044 |
| | 45,710 | 927 | 46,637 |
| Non-operating revenue: | | | |
| Interest income | 1,298 | | 1,298 |
| **TOTAL REVENUE** | $ 110,540 | $ 927 | $ 111,467 |
| **OPERATING EXPENSES** | | | |
| Salaries and wages | $ 15,699 | $ 872 | $ 16,571 |
| Employee benefits | 5,084 | 262 | 5,346 |
| City Central Services, including police | 5,847 | 239 | 6,086 |
| Materials and supplies | 7,278 | 366 | 7,644 |
| Contractual services | 22,700 | 300 | 23,000 |
| **TOTAL OPERATING EXPENSES** | $ 56,608 | $ 2,039 | $ 58,647 |

**CITY OF CLEVELAND - DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND**
**BURKE LAKEFRONT AIRPORTS**
**CUYAHOGA COUNTY**

**REPORT ON PASSENGER FACILITY CHARGES**

**FOR THE YEAR ENDED DECEMBER 31, 2004**

**Auditor of State**
**Betty Montgomery**

**CITY OF CLEVELAND**
**DEPARTMENT OF PORT CONTROL**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL AND BURKE LAKEFRONT AIRPORTS**
**REPORT ON PASSENGER FACILITY CHARGES**
**FOR THE YEAR ENDED DECEMBER 31, 2004**

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Auditor of State
Betty Montgomery

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE PASSENGER FACILITY CHARGE PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH 14 CFR PART 158**

Divisions of Cleveland Hopkins International and
Burke Lakefront Airports
Department of Port Control
City of Cleveland
Cuyahoga County
5300 Riverside Drive
Cleveland, Ohio 44135-3193

To the Honorable Jane L. Campbell, Mayor,
Members of Council and the Audit Committee:

**Compliance**

We have audited the compliance of the Divisions of Cleveland Hopkins International and Burke Lakefront Airports, Department of Port Control, City of Cleveland, Ohio, (the Divisions) with the compliance requirements described in the September 2000 *Passenger Facility Charge Audit Guide for Public Agencies,* issued by the Federal Aviation Administration (Guide), for its passenger facility charge program for the year ended December 31, 2004. Compliance with the requirements of laws and regulations applicable to its passenger facility charge program is the responsibility of the Divisions' management. Our responsibility is to express an opinion on the Divisions' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards;* and the Guide. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect occurred on the passenger facility charge program. An audit includes examining, on a test basis, evidence about the Divisions' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Divisions' compliance with those requirements.

In our opinion, the Divisions complied, in all material respects, with the requirements referred to above that are applicable to its passenger facility charge program for the year ended December 31, 2004.

**Internal Control Over Compliance**

The management of the Divisions is responsible for establishing and maintaining effective internal control over compliance with requirements of laws and regulations applicable to the passenger facility charge program. In planning and performing our audit, we considered the Divisions' internal control over compliance with requirements that could have a direct and material effect on the passenger facility charge program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Guide.

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Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws and regulations that would be material in relation to the passenger facility charge program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

**Schedule of Expenditures of Passenger Facility Charges**

We have audited the basic financial statements of the City of Cleveland, Divisions of Cleveland Hopkins Airport and Burke Lakefront Airport, Department of Port Control as of and for the year ended December 31, 2004, and have issued our report thereon dated May 31, 2005. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Passenger Facility Charges is presented for the purposes of additional analysis as specified by the Guide and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information of the audit committee, management, and the Federal Aviation Administration and is not intended to be and should not be used by anyone other than these specified parties.

Betty Montgomery

**Betty Montgomery**
Auditor of State

May 31, 2005

## Divisions of Cleveland Hopkins International and Burke Lakefront Airports
## Department of Port Control
## City of Cleveland

### Schedule of Expenditures of Passenger Facility Charges
### For the Year Ended December 31, 2004

| | Approved Project Budget | Cumulative Expenditures at 12/31/03 | 1st Quarter 2004 Expenditures | 2nd Quarter 2004 Expenditures | 3rd Quarter 2004 Expenditures | 4th Quarter 2004 Expenditures | Total 2004 Expenditures | Cumulative Expenditures at 12/31/04 |
|---|---|---|---|---|---|---|---|---|
| Insulate Residences - full program phase I | 16,960,400 | 16,770,155 | - | - | - | - | - | 16,770,155 |
| Extension of Taxiway "Q" | 2,500,000 | 2,155,743 | - | - | - | - | - | 2,155,743 |
| Land Acquisition - Resident Relocation | 16,883,240 | 14,642,543 | 46,916 | - | - | - | 46,916 | 14,689,459 |
| Sewer Construction | 5,500,000 | 5,500,000 | - | - | - | - | - | 5,500,000 |
| Asbestos Removal in Terminal CHIA | 1,000,000 | 729,842 | - | - | - | - | - | 729,842 |
| Acquisition of Analex Office Building and Vacant Land | 13,025,000 | 13,025,000 | - | - | - | - | - | 13,025,000 |
| Waste Water-Glycol Collection System Construction | 6,320,642 | 5,835,921 | - | - | - | - | - | 5,835,921 |
| NASA Feasibility and Pre-engineering Study | 355,000 | 355,000 | - | - | | - | - | 355,000 |
| Land Acquisition | 30,360,000 | 25,278,587 | - | - | - | 1,244 | 1,244 | 25,279,832 |
| Sound Insulation | 8,675,000 | 8,016,376 | 316,429 | 16,612 | 51,829 | - | 384,869 | 8,401,245 |
| Environmental Assessment/Impact Studies | 2,309,570 | 2,309,570 | - | - | - | - | - | 2,309,570 |
| Terminal Passenger Flow and Security Study | 300,000 | - | - | - | - | - | - | - |
| Railway System/Vehicular Ingress-Egress Study | 200,000 | - | - | - | - | - | - | - |
| Runway 5R Extension Engineering | - | - | - | - | - | - | - | - |
| Runway 5R Extension Design | - | - | - | - | - | - | - | - |
| Runway 5R Construction | - | - | - | - | - | - | - | - |
| FIS Facility Construction | - | - | - | - | - | - | - | - |
| FIS Facility Design | - | - | - | - | - | - | - | - |
| Brook Park Land Transfer | 8,750,000 | 3,142,693 | - | 334,031 | - | 334,031 | 668,062 | 3,810,755 |
| Analex Demolition | 1,229,000 | 84,923 | - | 46,917 | - | 46,917 | 93,834 | 178,757 |
| Sound Insulation | 20,000,000 | 8,760,446 | - | 1,628,720 | 695,901 | 381,750 | 2,706,371 | 11,466,817 |
| Baggage Claim/Expansion | 9,526,087 | 9,526,086 | - | - | - | - | - | 9,526,086 |
| Tug Road Replacement | 1,019,000 | 668,553 | - | - | - | - | - | 668,553 |
| Interim Commuter Ramp | 5,560,338 | 1,994,232 | - | 212,266 | - | 212,266 | 424,532 | 2,418,763 |
| Concourse D Ramp/Site Utilities | 51,305,804 | 18,406,061 | - | 1,958,598 | - | 1,958,598 | 3,917,196 | 22,323,258 |
| Burke Runway Overlay 6L/24R | 530,286 | 184,622 | - | 83,275 | - | 83,275 | 166,550 | 351,172 |
| Install Instrument Landing System-Burke | 2,181,400 | 572,193 | - | 20,244 | - | 20,244 | 40,487 | 612,680 |
| Runway 6L/23R | 82,106,000 | 4,344,515 | - | 3,134,395 | - | 3,134,395 | 6,268,790 | 10,613,305 |
| | 286,596,767 | 142,303,061 | 363,345 | 7,435,058 | 747,730 | 6,172,720 | 14,718,852 | 157,021,913 |

**Divisions of Cleveland Hopkins Airport and Burke Lakefront Airport**
**Department of Port Control**
**City of Cleveland**

**Notes to Schedule of Expenditures of Passenger Facility Charges**
**For the Year Ended December 31, 2004**

## General

The accompanying schedule presents all activity of the Airport's Passenger Facility Charge (PFC) program. The Airport's reporting entity is defined in Note A to the Airports' financial statement.

## Basis of Presentation

The accompanying schedule is presented on the cash basis of accounting.

Auditor of State
Betty Montgomery

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**CITY OF CLEVELAND**
**DIVISIONS OF CLEVELAND HOPKINS INTERNATIONAL &**
**BURKE LAKEFRONT AIRPORTS**

**CUYAHOGA COUNTY**

**CLERK'S CERTIFICATION**

**This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.**

Susan Babbitt

**CLERK OF THE BUREAU**

**CERTIFIED**
**JULY 14, 2005**