OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

RONALD C. GREEN

To: Mayor Annise D. Parker
City Council Members

From: Ronald C. Green
City Controller

Date: February 2, 2010

Subject: **December 2009 Financial Report**

Attached is the Monthly Financial and Operations Report for the period ending December 31, 2009.

GENERAL FUND

The Controller's office is projecting an ending fund balance of $135.161 million for FY2010. This is $5.2 million lower than last month's projection. This is also $28.7 million lower than the projection of the Finance Department. The difference between our revenue projection and that of the Finance department is due to the following:
(a) Finance's revenue projection is $13 million higher than ours; (b) Finance is including $6.2 million of transfers not yet approved by City Council; and (c) Finance is including $9.5 million of Sale of Capital Assets not yet finalized. Based on our current projections, the fund balance will be $9.5 million above the City's target of holding 7.5% of total expenditures, excluding debt service, in reserve.

Our revenue projection decreased $6 million, all of which is attributable to Sales Tax revenue. Our latest Sales Tax payment from the State was 18.5% lower than the same month last year. The payment last year included taxes earned due to Hurricane Ike repairs.

Expenditure projections decreased $818,000. Our projection for IT increased $1.8 million reflecting budget transfers from Fire (decrease $954,000) and Police (decrease $820,000) for the citywide radio migration project. Administration and Regulatory Affairs (ARA) increased $454,000 primarily to finalize the transfer of BARC from Health (decrease $385,000). Legal also increased $464,000 to restore necessary positions that were removed from their budget recently. Finally, our projection for General Government decreased $1.4 million reflecting savings in health benefit premiums from the creation and use of the new Single Non-Profit Trust.

ENTERPRISE FUNDS

In the Aviation Operating Fund, our projection for Parking and Concession revenue decreased $615,000 for lower than expected Garage Parking fees. The projection for Operating Expenses decreased approximately $5.1 million, mainly for lower utility usage than planned. Finally, our projection for Operating Transfers increased $4.5 million reflecting the lower spending levels projected.

Our projection for Combined Utility System Operating Revenues decreased $3.3 million mainly due to lower than expected usage by the Water Authorities. We also reduced Operating Expenses by $5.2 million for expenses in

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Contracts and Non-Capital Equipment being moved to Equipment Acquisition in the Operating Transfers projection. Finally, our projection for Sale of Property has been reduced $1.6 million to reflect current economic conditions affecting the market.

There are no material changes to our projections for Convention & Entertainment, Parking Management, and Stormwater funds.

COMMERCIAL PAPER AND BONDS

The City's practice has been to maintain no more than 20% of the total outstanding debt for each type of debt in a variable rate structure. Convention and Entertainment maintains a higher percentage of variable rate debt due to agreements with the hotel corporation. As of December 31, 2009 the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	6.2%
Combined Utility System	5.4%
Aviation	16.9%
Convention and Entertainment	30.5%

Respectfully submitted,

Ronald C. Green
City Controller

City of Houston, Texas
Quarterly Swap Agreements Disclosure
December 31, 2009

I. General Obligation Swap

On August 28, 2009, the City elected to terminate this swap. The City received a termination payment of $2.4 million. The original terms of the transaction are listed below.

Objective. On February 20, 2004 the City entered into a basis swap referred to as a synthetic reduced variance coupon swap with RFPC, LLC ("RFPC"). The objective of the swap was to reduce the City's fixed rate debt service costs through a swap structure that takes on basis risk.

Terms. On a notional value of $200 million, the City paid an amount equal to the market standard SIFMA Index rate divided by .667, up to a maximum of 10%, and received the taxable six-month US Dollar LIBOR rate plus a constant of 69 basis points. Payments were made every six months based on indices for the prior budget period. The original agreement became effective on March 1, 2004.

Receipts. Revenue earned on this swap totaled $7.6 million including a $2.4 million termination payment to the City.

II. Combined Utility System Swaps

A. Combined Utility System Synthetic Fixed Rate Swap

On June 10, 2004 the City entered into three pay-fixed, receive-variable rate swap agreements ("the 2004B Swaps") related to the Combined Utility System 2004B auction rate variable interest bonds ("the 2004B Bonds"). The City pre-qualified six firms to submit competitive bids on the swaps. The three firms selected all matched the lowest fixed rate bid of 3.78%. As of April 14, 2008 the City had converted all of the 2004B bonds from auction rate to variable rate demand bonds.

Objective. The objective of the swaps is to hedge against the potential of rising interest rates associated with the 2004B Bonds and to achieve a lower fixed rate than the market rate for traditional fixed rate debt at time of issuance of the 2004B Bonds. The City's goal is that its variable receipts under these swaps equal the variable payments made on the bonds, leaving the fixed payment on the swap, plus dealer and liquidity fees, as its net interest cost.

Terms. The notional amounts of the swap agreements total $653.3 million, the principal amount of the associated 2004B Bonds. The City's swap agreements contain scheduled reductions to outstanding notional amounts that follow anticipated payments of principal of the 2004B Bonds in varying amounts during the years 2028 to 2034.

Under the terms of the swaps, the City will pay a fixed rate of 3.78% and receive a floating rate equal to 57.6% of One-Month US Dollar LIBOR plus 37 basis points. All agreements were effective June 10, 2004, the date of issuance of the 2004B Bonds. The termination date is May 15, 2034.

Receipts and Payments. For the six months ended December 31, 2009, the City earned $1.7 million in swap revenue for its 2004B swaps and paid $1.0 million of interest on the underlying securities. The contractual rate for the City's swap payment is 3.78%. The average effective rate for the 2004B bonds, including interest for the Series 2004B bonds, the City's swap payments, and its dealer and liquidity fees, reduced by swap receipts, was 3.98%. In contrast, the comparable fixed rate the City paid on its Combined Utility System Series 2004A bonds, was 5.08%.

Fair value. Because interest rates have changed, the swaps had an estimated negative fair value of $77.6 million on December 31, 2009. This value was calculated using the zero-coupon method.

Credit risk. As of this date, the City was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk on the swap in the amount of its fair value. If a counterparty's credit rating falls below rating thresholds established by the agreements, collateral must be posted in varying amounts depending on the credit rating and swap fair value. No collateral has been required to date.

Counterparty	Notional Amount	Fair Value	Counterparty Credit Rating (Moody's/S&P/Fitch)
Goldman Sachs Capital Markets Inc.	$ 353,325,000	$ (41,952,000)	A1 /A /A+
JP Morgan Chase	150,000,000	(17,810,000)	Aa3/ AA-/AA-
UBS AG	150,000,000	(17,810,000)	Aa1 /AA- /AA-
	$ 653,325,000	$ (77,572,000)	

Basis risk. The City is exposed to basis risk on the swaps because the variable payment received is based on a different taxable index from the tax-exempt rate paid by the City on the bonds. Should the relationship between taxable LIBOR and tax-exempt rates move to convergence (because of reductions in tax rates, for example), the expected cost savings may not be realized. For the six months ended December 31, 2009, the average variable rate paid on the underlying tax-exempt bonds was 0.30%, 0.22% lower than the average 0.52% LIBOR-based rate received for the swap. On December 31, 2009, the interest rate in effect for the underlying bonds was 0.25%, 0.26% lower than the 0.51% rate in effect for swap receipts.

Remarketing risk. The City faces a risk that the remarketing agent will not be able to sell the variable rate demand bonds at a competitive rate. Rates may vary considerably as investors shift in and out of the tax-exempt variable rate sector.

Termination risk. The City may terminate for any reason. A counterparty may terminate a swap if the City fails to perform under the terms of the contract. The City's on-going payment obligations under the swap (and to a limited extent, its termination payment obligations) are insured, and counterparties cannot terminate so long as the insurer does not fail to perform. If a swap is terminated, the associated variable-rate bonds would no longer carry synthetic fixed interest rates. Also, if the swap has a negative fair value at termination, the City would be liable to the counterparty for a payment equal to the swap's fair value.

B. Combined Utility System Forward Rate Lock/Synthetic Fixed Rate Swap

On November 1, 2005 the City priced a floating to fixed interest rate exchange agreement swap with Royal Bank of Canada ("RBC") on a forward basis. The City pre-qualified eight firms to submit competitive bids, and RBC submitted the lowest bid of 3.761%.

Objective. The objective of the swap is to hedge against the potential of rising interest rates associated with its Combined Utility System Series 2008A Bonds ("the 2008A Bonds") and to achieve a lower fixed rate than the market rate for traditional fixed rate debt. This swap was originally assigned to $249.1 million of the 2004C auction rate bonds, which were refunded by the 2008A variable rate demand bonds in May 2008. The City's goal is that its variable receipts under these swaps equal the variable payments made on the bonds, leaving the fixed payment on the swap, plus dealer and liquidity fees, as its net interest cost.

Terms. The notional amount of the swap is $249.1 million with the underlying bonds being the Series 2008A Bonds. The swap agreement contains scheduled reductions to the outstanding notional amount that follows anticipated payments of principal of the 2008A Bonds during the years 2028 to 2034.

Under terms of the swap, the City pays a fixed rate of 3.761% and receives a floating rate equal to 70% of One-Month US Dollar LIBOR. The agreement became effective December 3, 2007 with a termination date of May 15, 2034.

Receipts and Payments. For the six months ended December 31, 2009, the City earned $237,000 in swap revenue for its 2008A swap and paid $361,000 of interest on the underlying securities. The contractual rate for the City's swap payment is 3.761%. The average effective rate for the bonds, including interest for the bonds, the City's swap payments, and its dealer and liquidity fees reduced by swap receipts, was 4.30%.

Fair value. Because interest rates have changed, the swap had an estimated negative fair value of $22.1 million on December 31, 2009. This value was calculated using the zero-coupon method.

Credit risk. The City's swap policy generally requires that swap counterparties be rated double-A or better by at least one nationally recognized rating agency. As of this date, RBC met this requirement with ratings of Aaa/AA-/AA. Also, under the agreement, if RBC's credit rating falls below double-A, collateral must be posted in varying amounts depending on the credit rating and swap fair value. No collateral has been required to date.

Basis risk. The City will be exposed to basis risk on the swap because the variable payment received is based on a taxable index other than the tax-exempt rate paid by the City on the bonds. In the future, if tax-exempt rates move to convergence with the taxable LIBOR index (because of reductions in tax rates, for example), the expected cost savings may not be realized, resulting in a higher synthetic rate. For the six months ended December 31, 2009, the average variable rate paid on the underlying tax-exempt bonds was 0.28%, 0.09% higher than the average 0.19% LIBOR-based rate received for the swap. At December 31, 2009, the interest rate in effect for the underlying bonds was 0.22%, 0.05% higher than the 0.17% rate in effect for the swap receipts.

Termination risk. The City may terminate for any reason. RBC may terminate a swap if the City fails to perform under the terms of the contract. The City's on-going payment obligations under the swap (and to a limited extent, its termination payment obligations) are insured, and RBC cannot terminate so long as the insurer does not fail to perform. If a swap is terminated, the associated variable-rate bonds would no longer carry synthetic fixed interest rates. Also, if the swap has a negative fair value at termination, the City would be liable to the counterparty for a payment equal to the swap's fair value.