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: April 30, 2010

Subject: March 2010 Financial Report

Attached is the Monthly Financial and Operations Report for the period ending March 31, 2010.

GENERAL FUND

The Controller's office is projecting an ending fund balance of $132.2 million for FY2010. This is $9.1 million lower than last month's projection. This is also $27.6 million lower than the projection of the Finance Department. The difference between our projection and that of the Finance department is due to the following: (a) Finance's revenue projection is $17.9 million higher than ours; (b) Finance is including $1.5 million of transfers not yet approved by City Council; and (c) Finance is including $8.2 million of Sale of Capital Assets not yet finalized. Based on our current projections, the fund balance will be $6.8 million above the City's target of holding 7.5% of total expenditures, excluding debt service, in reserve.

Our revenue projection decreased $11.2 million. Our projection for Sales Tax revenues decreased by $12.2 million reflecting continued monthly receipts lower than expected, which was down 7.85% from the same month prior year in the most recent receipt from the state. We increased our projection in Charges for Services by $917,000 for receipts trending higher than expected in Ambulance Fees, Building Rentals, and Public Safety report fees. Our projection for Direct Interfund decreased $618,000, due to lower than expected allowable charges to Aviation for Fire Services and building maintenance service charges. Municipal Courts Fines & Forfeits increased $597,000 to reflect several revenues trending higher (Non-Traffic Fines, Local Arrest Fees, and Dismissal Fees). Our projection for Interest increased $750,000 mainly reflecting higher YTD revenues thru March. Finally, we decreased Miscellaneous/Other by $1.3 million for lower Recoveries and Refunds and Miscellaneous revenues.

Expenditure projections decreased $2.6 million. Our projection for Fire increased $2.6 million primarily for higher termination pay. We also decreased our projection for several departments to recognize the 0.7% reductions, primarily in Police ($2.6 million), Library ($262,000), and Solid Waste ($492,000), as well as other departments in lesser amounts. Lastly, we reduced the projection for General Government by $874,000 for contingency funds not expected to be used.

ENTERPRISE FUNDS

In the Aviation Operating Fund, we have increased our projection for Operating Revenues $2.2 million for increased revenues in Parking and Concessions. We also decreased our projection for Operating Expenses by $4.8 million, primarily for savings in Services, in numerous expense items. Non-Operating Revenues decreased

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$480,000 for lower than expected Interest Income. Finally, the projection for Operating Transfers increased $6.5 million to reflect lower debt service transfers, as funds are available from other sources to cover the amount, which increases the amount available to transfer for Capital Improvements.

Within the Convention & Entertainment Facilities Operating Fund, we are reducing our projection for Total Operating Revenues by $1.4 million for lower Parking and Concessions revenues from lower event attendance. We have also increased our projection for Net HOT Tax by $359,000 for higher delinquent collections. Lastly, we have increased our projection for Non-Operating revenue $3.6 million for higher than expected returns from Houston Convention Center Hotel Corporation.

Our projection for Combined Utility System Operating Revenues decreased $7.6 million, again mainly due to lower than expected usage by the Water Authorities and commercial customers. We also decreased Operating Expenses by $8.7 million, mainly for Electricity and Contract costs. Finally, we decreased our projection for Operating Transfers by $15.1 million mainly for System Debt Service Transfers for variable rate cost lower than expected.

In the Parking Management Operating Fund, we have decreased our projection for Operating Expenses by $526,000 for lower Services costs that will not occur this year. We also increased our projection for Operating Transfers by $270,000 for higher transfers out for Meter revenues collected.

The projection for Total Expenditures in the Stormwater Fund was increased $362,000 mainly for vehicles now expected to be received before year-end. We also decreased our projection for Other Financing Sources $1.6 million mainly for lower System Transfers In which will be covered by the use of fund balance.

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 March 31, 2010 the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	8.0%
Combined Utility System	5.9%
Aviation	16.9%
Convention and Entertainment	30.3%

City of Houston, Texas
Quarterly Swap Agreements Disclosure
March, 31, 2010

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 nine months ended March 31, 2010, the City earned $2.6 million in swap revenue for its 2004B swaps and paid $1.3 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 3.95%. 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 $80.1 million on March 31, 2010. 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	$ (43,306,000)	A1 /A /A+
JP Morgan Chase	150,000,000	(18,385,000)	Aa1/ A+/AA-
UBS AG	150,000,000	(18,385,000)	Aa3 /A+ /A+
	$ 653,325,000	$ (80,076,000)	

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 nine months ended March 31, 2010, the average variable rate paid on the underlying tax-exempt bonds was 0.27%, 0.25% lower than the average 0.52% LIBOR-based rate received for the swap. On March 31, 2010, the interest rate in effect for the underlying bonds was 0.27%, 0.23% lower than the 0.50% 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 nine months ended March 31, 2010 the City earned $339,000 in swap revenue for its 2008A swap and paid $494,000 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 4.29%.

Fair value. Because interest rates have changed, the swap had an estimated negative fair value of $23.3 million on March 31, 2010. 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 nine months ended March 31, 2010, 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 March 31, 2010, the interest rate in effect for the underlying bonds was 0.24%, 0.08% higher than the 0.16% 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.

Respectfully submitted,

Ronald C. Green

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City Controller