



OFFICE OF THE CITY CONTROLLER  
CITY OF HOUSTON  
TEXAS

**To:** Mayor Annise D. Parker  
City Council Members

**From:** Ronald C. Green  
City Controller

**Date:** January 27, 2012

**Subject: December 2011  
Financial Report**

Attached is the Monthly Financial and Operations Report for the period ending December 31, 2011.

**GENERAL FUND**

The Controller's office is projecting an ending fund balance of \$130.1 million for FY2012. This is \$15.4 million lower than the projection of the Finance Department. The difference is due to a \$12.9 million higher revenue projection from the Finance Department and a \$1.5 million higher projection for the Sale of Capital Assets from the Finance Department. Based on our current projections, the fund balance will be \$9.4 million **above** the City's target of holding 7.5% of total expenditures, excluding debt service, in reserve. This amount includes the undesignation of the \$20 million in the Rainy Day Fund.

While we have increased and decreased several revenue projections, the total remained approximately flat. Sales Tax was increased \$2.8 million to recognize November receipts, which were higher than expected. We decreased our projection for Other Taxes \$1.4 million for lower than projected Mixed Beverage tax receipts. Telephone Franchise Fees was increased \$1.2 million, reflecting current trends. Our projection for Licenses & Permits increased \$1.7 million for additional receipts in Special Fire permits, Administrative Fees, and Dumpster Permits. Charges for Services was decreased \$700,000 for lagging receipts in Platting Fees and Certified Copy Fees. The largest change was in Municipal Courts Fines & Forfeits, which we are decreasing \$4 million. This is due to lower than expected ticket issuance in the early months of the fiscal year. Finally, we are increasing Miscellaneous/Other revenues \$444,000 for higher than expected receipts in Sale of Scrap, Contributions from Others, and Miscellaneous revenues.

The major differences (over \$1 million) are in nine categories: (1) Property Tax revenues are \$3.3 million lower than the Finance Department due to the Controller's office using a collection rate of 97.4% versus 97.7% for Finance. (2) Finance is projecting Other Taxes \$1.4 million higher than the Controller's projection, mainly from Mixed Beverage receipts. (3) Telephone Franchise Fees are \$1.1 million higher than the Finance Department. (4) Finance is projecting Other Franchise fees \$1.1 million higher than Controller's, mainly for Cable and Solid Waste fees. (5) Finance is reporting Licenses and Permits \$2.7 million higher than the Controller's projection. The Controller's office recognized the fee increases, and has increased our projection in those trending higher at this time. (6) Finance is reporting Charges for Services \$2.3 million higher than the Controller's projection. Ambulance fees are the largest single revenue in this category. (7) Finance is reporting Municipal Courts Fines & Forfeits \$2.9 million higher than Controller's projection. Low ticket issuance in the beginning of the fiscal year has caused the collections to be under budget. (8) Finance is reporting Miscellaneous/Other revenues \$1.1 million higher than the Controller's projection. Many of these revenue sources are non-recurring. (9) Sale of Capital Assets are \$1.5 million lower than the Finance Department, as the Controller's office has not recognized all proposed land sales, which have yet to be finalized and approved by Council.

**Mayor Annise D. Parker  
City Council Members  
December 31, 2011 Monthly Financial and Operations Report**

Expenditure projections decreased \$3.5 million, but are still \$2.1 million above the Adopted Budget. Our projection for most departments have decreased \$5.1 million for lower Health Benefits costs, from more employees choosing the lower cost plan. This was partially offset by an increase in Electricity costs of \$1.2 million, and \$500,000 costs to maintain Solid Waste drivers' licenses. We have also decreased Finance and ARA projections, and increased Mayor projection \$3.1 million to more accurately reflect departmental functions.

**ENTERPRISE FUNDS**

In the Aviation Operating Fund, we have increased our projection for Operating Revenues \$1.8 million for higher building space rentals and auto rentals. We have also decreased our projection for Operating Expenses \$201,000. This is a savings in supplies (mainly chemicals, parts, and fuel). We have also decreased our projection for Debt Service Interest transfer by \$473,000. Multiple variables cause variances in the timing of the payments, changing the interest cost slightly.

Within the Convention & Entertainment Facilities Operating Fund, we have increased our projection for Operating Transfers \$873,000 reflecting the current cost of the new debt service required funding.

Our projection for the Combined Utility System Operating Revenues increased \$9 million for continuing high usage from drought conditions. We have also decreased our projection for Operating Expenses \$2.8 million, mainly from savings in personnel of \$5.2 million, offset by an increase in Contracts of \$2.5 million (emergency repairs). Operating Transfers projection was decreased \$7.8 million primarily for Debt savings from a smaller FY2011 bond issue than planned, and refunding savings.

In the Dedicated Drainage & Street Renewal Fund we have decreased both revenue and expense \$2.9 million to reflect funding going straight to the capital fund for METRO bus stop shelter construction.

Our projection for Stormwater Fund Transfers In-CUS decreased \$308,000 for lower revenue from CUS.

**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, 2011, the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	8.2%
Combined Utility System	3.4%
Aviation	16.9%
Convention and Entertainment	18.3%

Respectfully submitted,



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Ronald C. Green  
City Controller

**City of Houston, Texas**  
**Quarterly Swap Agreements Disclosure**  
**December 31, 2011**

**I. 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, 2011, the City earned \$1.6 million in swap revenue for its 2004B swaps and paid \$422,700 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 4.52%. 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 \$210.7 million on December 31, 2011. 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	\$ (113,924,000)	A1 /A -/A
JP Morgan Chase	150,000,000	(48,366,000)	Aa3/ A/AA-
UBS AG	150,000,000	(48,366,000)	Aa3 /A /A
	<u>\$ 653,325,000</u>	<u>\$ (210,656,000)</u>	

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, 2011, the swap generated positive cash flow with the average variable rate paid on the underlying tax-exempt bonds at 0.13%, or 0.36% lower than the average 0.49% LIBOR-based rate received for the swap. On December 31, 2011, the interest rate in effect for the underlying bonds was 0.08%, 0.44% lower than the 0.52% 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 City entered the swap agreement to hedge against the potential of rising interest rates and to achieve a lower fixed rate than the market rate for traditional fixed rate debt. This swap was previously assigned to the 2008A variable rate demand bonds, which were refunded on March 30, 2010 with the 2010B SIFMA Indexed Notes. The addition of the SIFMA-Indexed Notes diversifies the System's variable rate debt portfolio. Rates on the notes are calculated at SIFMA +130 bps, and the notes expire in March 2013.

Terms. The notional amount of the swap is \$249.1 million with the underlying bonds being the Series 2010B Notes. The swap agreement contains scheduled reductions to the outstanding notional amount 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, 2011, the City earned \$193,000 in swap revenue for its 2010B swap and paid \$171,000 on the underlying notes. The contractual rate for the City's swap payment is 3.761%. The average effective rate for the bonds, including the City's swap payments and a fixed component of 1.30%, was 5.04%.

Fair value. Because interest rates have changed, the swap had an estimated negative fair value of \$82.4 million on December 31, 2011. 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 Aa1/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 SIFMA based 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, 2011, the average variable rate paid on the underlying tax-exempt bonds, excluding the fixed credit spread component, was 0.13%, 0.02% lower than the average 0.15% LIBOR-based rate received for the swap. At December 31, 2011, the overall rate in effect for the underlying bonds, excluding the fixed spread component, was 0.10%, 0.08% lower than the 0.18% 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.