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: August 3, 2012

Subject: June 2012 Financial Report

Attached is the Monthly Financial and Operations Report for the period ending June 30, 2012.

GENERAL FUND

The Controller's office is projecting an ending fund balance of $151.8 million for FY2012. This is $6.7 million lower than the projection of the Finance Department. The difference is due to a $6.7 million higher revenue projection from the Finance Department. Based on our current projections, the fund balance will be $31.6 million **above** the City's target of holding 7.5% of total expenditures, excluding debt service, in reserve. This amount includes the un-designation of the $20 million in the Rainy Day Fund in FY2011, as well as the designation of $2.7 million of contingent funding of the DARLEP settlement, and designation of $5 million back to the Rainy Day Fund in FY2012.

While we have changed several revenue projections, the total increased $9.2 million over last month's projection. Sales Tax increased $4.6 million, reflecting the May receipt being above our previous projection. Our projection for Licenses & Permits increased $1.4 million for additional receipts of Food Dealer Permits and Plan Reviews. Charges for Services increased $3.2 million, primarily for higher Ambulance Revenues, after year-end contract analysis. We decreased our projection for Direct Interfund for final Airport Police amounts. Our projection for Municipal Courts Fines and Forfeits increased $752,000 for higher receipts in Suspended Sentences and Failure to Appear revenues. Miscellaneous/Other revenues were increased $327,000 for additional Recoveries and Refunds received. Finally, we increased our projection of Transfers from Other Funds $490,000 for higher Hotel Occupancy Taxes received.

The major differences (over $1 million) are still in only three categories: (1) Property Tax revenues are $1.9 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 reporting Sales Tax $2.6 million higher than the Controller's projection. Currently one month revenues are unknown. (3) Finance is reporting Municipal Courts Fines & Forfeits $1.5 million higher than Controller's projection. Low ticket issuance in the beginning of the fiscal year has caused the collections to be under budget.

The expenditure projection was decreased $13.1 million from last month's report. Several departments were decreased, primarily for savings in personnel costs, for positions not filled. Police increased $1.9 million for higher fuel and health benefits costs. General Government was also decreased $7.1 million due to savings in Claims and Judgements of $5.3 million, and the amount increased to Police of $1.8 million

Mayor Annise D. Parker
City Council Members
June 30, 2012, Monthly Financial and Operations Report

ENTERPRISE FUNDS

In the Aviation Operating Fund, we have increased our projection for Operating Revenues \$3.9 million for higher than expected Parking and Concession revenues, from higher passenger levels. Our projection for Operating Expenses decreased \$10 million, from lower personnel costs, maintenance services, and drainage fees. A corresponding increase was applied to the Capital Improvement Transfer.

Within the Convention & Entertainment Facilities Operating Fund, we have decreased our projection for Operating Revenues \$251,000, for lower parking revenues. Operating Transfers decreased \$265,000 which was a net change of a higher debt transfer of \$1.47 million, and a decrease of Transfer to Component Unit of \$1.7 million.

Our projection for the Combined Utility System Operating Revenues increased \$12.2 million primarily for increased water usage in May and June. Operating Expenses decreased \$4.2 million mainly for lower project costs and rebate expenses. Non-Operating revenues increased \$1.7 million reflecting higher interest, sales of scrap, and cost recoveries. We have also decreased our projection for Operating Transfers \$2.4 million mainly for lower interest costs on variable rate debt and commercial paper.

In the Dedicated Drainage & Street Renewal Fund, we have decreased our revenue projection \$907,000 for adjusted drainage fees. We also decreased expenses \$9.9 million for lower than expected project costs.

Our projection in the Stormwater fund expenditures decreased \$1 million for lower interest rate on commercial paper, and delays in bond issuance.

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. As of June 30, 2012, the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	6.6%
Combined Utility System	3.1%
Aviation	17.0%
Convention and Entertainment	18.3%

Respectfully submitted,

Ronald C. Green

Ronald C. Green
City Controller

City of Houston, Texas
Quarterly Swap Agreements Disclosure
June 30, 2012

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 twelve months ended June 30, 2012, the City earned $3.4 million in swap revenue for its 2004B swaps and paid approximately $1 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 4.53%. 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 $235.5 million on June 30, 2012. 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	$ (127,365,000)	A3 /A-/A
JP Morgan Chase	150,000,000	(54,072,000)	A2/ A/A+
UBS AG	150,000,000	(54,072,000)	A2 /A /A
	$ 653,325,000	$ (235,509,000)	

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 twelve months ended June 30, 2012, the swap generated positive cash flow with the average variable rate paid on the underlying tax-exempt bonds at 0.15%, or 0.36% lower than the average 0.51% LIBOR-based rate received for the swap. On June 30, 2012, the interest rate in effect for the underlying bonds was 0.22%, 0.29% 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 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 twelve months ended June 30, 2012, the City earned $420,000 in swap revenue for its 2010B swap and paid $373,000 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 $99.3 million on June 30, 2012. 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 Aa3/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 twelve months ended June 30, 2012, the average variable rate paid on the underlying tax-exempt bonds, excluding the fixed credit spread component, was 0.15%, 0.02% lower than the average 0.17% LIBOR-based rate received for the swap. At June 30, 2012, the overall rate in effect for the underlying bonds, excluding the fixed spread component, was 0.18%, 0.01% 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.