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: January 25, 2013

Subject: December 2012 Financial Report

Attached is the Monthly Financial and Operations Report for the period ending December 31, 2012.

GENERAL FUND

The Controller's Office is projecting an ending fund balance of $130.8 million for FY2013. This is $30.4 million lower than the projection of the Finance Department. The difference is due to a $30.4 million higher revenue projection from the Finance Department. Based on our current projections, the fund balance will be $1.6 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, and reimbursement of $20 million. I would like to point out that the Administration's new plan to replenish the Rainy Day Fund the additional $15 million in FY2013 will comply with Ordinance 2003-474, which requires that "The City shall allocate sufficient funds during the subsequent two fiscal years to replenish any use of Rainy Day funds in the previous year."

The only changes in our revenue projections are an increase of $1.75 million in Sales Tax, recognizing the November sales tax receipt that was up 7.38% over the prior year, and an increase in Direct Interfund revenues of $687,000 for additional receipts covering increased costs incurred in ARA and GSD.

The major differences are now in eight categories: (1) Property Tax revenues are still $9.8 million lower due to the Controller's Office using a higher TIRZ payment projection. (2) Industrial Assessments are still $1.9 million lower as Controller's Office is using a lower collection rate than Finance. (3) Sales Tax revenues are now $9.4 million lower, as the Controller's Office is using Barton Smith's April 2012 growth estimate, discounted by his margin of error, plus actual receipts for July through November 2012. (4) Licenses & Permits are now $1.6 million lower, as we are awaiting additional data on several annual permit categories for the year. (5) Charges for Services are still $1.4 million lower, as the Controller's Office is projecting slightly lower Ambulance collections. (6) Municipal Courts are still $3 million lower, as the Controller's Office expects lower ticket issuance than Finance. (7) Interest is still $1 million lower reflecting lower cash balances and lower interest rates. (8) Miscellaneous/Other is still $1.8 million lower because of one-time revenues.

Expenditure projections have increased $13.8 million, which is $16.3 million above the Adopted Budget. Our projection for Administration and Regulatory Affairs increased $373,000 for personnel reassigned to 3-1-1 from BARC, and an increase of $314,000 in General Services for maintenance costs at Houston Transtar, which are both offset by increased interfund revenues. We have also increased the projection for General Government $11.2 million. This is an increase of $12 million to cover the Health Benefits Fund shortfall incurred in FY2012, an increase of $1.1 million to Limited Purpose Annexation payments, netted with a decrease of $1.9 million in electricity contingencies, which is being moved to Public Works, increasing their projection.

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Mayor Annise D. Parker
City Council Members
December 2012 Monthly Financial and Operations Report

ENTERPRISE FUNDS

In the Aviation Operating Fund, we have increased our projection for Operating Revenues $5.2 million for higher than expected Parking and Concessions revenues, from higher passenger levels. Our projection for Operating Expenses decreased $564,000 mainly for savings in personnel. We also increased Non-Operating Revenues $691,000 for sale of easements at Ellington Field. These changes caused an increase of $6.4 million to the Capital Improvement Transfer.

Our projection for the Combined Utility System Operating Expenses increased $654,000 mainly for higher fleet repair costs. Operating Transfers decreased $1.1 million for a lower transfer to Storm Water, and lower variable rate debt transfer costs.

In the Dedicated Drainage & Street Renewal Fund, we have decreased our projection for Expenditures $365,000 mainly for savings in personnel.

Our projection in the Stormwater Fund Operating Transfers In decreased $600,000.

There were no material changes in the Convention & Entertainment Fund this month.

HEALTH BENEFITS FUND

I would like to bring to your attention the Administration's new plan to fund the Health Benefits Fund for the FY2012 negative Net Assets of $14.1 million on pg III-1. This was due to an Operating Loss of $17.5 million for FY2012, the first year under the new City health insurance model. The shortfall is not expected to occur again in FY2013.

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 December 31, 2012, the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	7.6%
Combined Utility System	3.0%
Aviation	17.4%
Convention and Entertainment	18.3%

Respectfully submitted,

Ronald C. Green

Ronald C. Green
City Controller

City of Houston, Texas
Quarterly Swap Agreements Disclosure
December 31, 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 August 15, 2012 the City had converted all of the 2004B bonds from auction rate to variable rate demand bonds ("the 2004B bonds) and SIFMA-Index notes ("the 2012A and 2012B Refunding Bonds), collectively referred to herein as the "Bonds."

Objective. The objective of the swaps is to hedge against the potential of rising interest rates associated with the Bonds and to achieve a lower fixed rate than the market rate for traditional fixed rate debt at time of issuance. 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 and the fixed spread to SIFMA, as its net interest cost.

Terms. The notional amounts of the swap agreements total $653.3 million, the principal amount of the associated Bonds. The City's swap agreements contain scheduled reductions to outstanding notional amounts that follow anticipated payments of principal of the 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 original date of issuance of the Bonds. The termination date is May 15, 2034.

Receipts and Payments. For the three months ended December 31, 2012, the City earned $1,666,625 in swap revenue for these swaps and paid $518,494 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 4.29%. 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 $195.5 million on December 31, 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	$ (105,745,000)	A3 /A- /A
JP Morgan Chase	150,000,000	(44,895,000)	A2/ A/A+
UBS AG	150,000,000	(44,895,000)	A2 /A /A
	$ 653,325,000	$ (195,536,000)	

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 three months ended September 30, 2012, the swap generated positive cash flow with the average variable rate paid on the underlying tax-exempt bonds at 0.16%, or 0.35% lower than the average 0.51% LIBOR-based rate received for the swap. On September 30, 2012, the interest rate in effect for the underlying bonds was 0.18%, 0.32% 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 each week. There is no remarketing risk associated with the SIFMA index notes until the end of the respective maturities in 2015 and 2017. 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 and the 2010B SIFMA Indexed Notes. The swap is currently associated with the 2012C SIFMA Indexed Notes, which refunded the 2010 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 +60 bps, and the notes expire in 2016.

Terms. The notional amount of the swap is $249.1 million with the underlying bonds being the Series 2012C 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 three months ended December 31, 2012, the City earned $202,853 swap revenue for its 2012C swap and paid $190,730 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 0.68%, was 4.43%.

Fair value. Because interest rates have changed, the swap had an estimated negative fair value of $77.0 million on December 31, 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 may be requested 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 three months ended December 31, 2012, the average variable rate paid on the underlying tax-exempt bonds, excluding the fixed credit spread component, was 0.15%, 0.01% lower than the average 0.16% LIBOR-based rate received for the swap. At December 31, 2012, the overall rate in effect for the underlying bonds, excluding the fixed spread component, was 0.18%, 0.03% higher than the 0.15% 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.