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: July 30, 2010

Subject: June 2010 Financial Report

Attached is the Monthly Financial and Operations Report for the period ending June 30, 2010.

GENERAL FUND

The Controller's office is projecting an ending fund balance of $157.2 million for FY2010. This is $7.5 million higher than last month's projection. This is also $3 million lower than the projection of the Finance Department. Based on our current projections, the fund balance will be $31 million above the City's target of holding 7.5% of total expenditures, excluding debt service, in reserve.

Our revenue projection increased $8.1 million. Our projection for Sales Tax revenues increased by $3.3 million reflecting the May revenues higher than expected, but only up 1% compared to the same month prior year. Other Taxes was increased $672,000 reflecting the final receipt of Mixed Beverage taxes. Other Franchise Fees increased $362,000 for higher fees received in Cable Franchise Fees. We also increased Licenses & Permits $1.7 million for Special Fire and Food Dealer Permits above estimates. Our projection for Charges for Services increased $1.9 million, in Ambulance Fees and Platting Fees. Direct Interfund decreased $1.8 million for lower CIP costs recovered. Municipal Courts Fines & Forfeits was increased $719,000 for higher Local Arrest fees and Suspended Sentence fees. Finally, we increased our projection for Misc/Other $1.2 million, primarily to recognize a rate case reimbursement now expected to be received this year.

General Fund expenditure projections increased $984,000. This was net of several changes. Fire was increased $1.8 million for higher than expected classified overtime and supplies. General Government was increased $1.1 million for higher LPA payments related to Sales Tax revenues. General Services increased $827,000 and Parks $307,000 for higher than expected water and sewer costs. Solid Waste decreased $1.2 million for lower personnel and waste disposal fees. Finally, Finance, Legal, and PWE decreased by a total of $1.4 million for savings in personnel.

Our projection for Transfers from Other Funds increased $253,000. This was to recognize additional funds received from DARLEP.

ENTERPRISE FUNDS

In the Aviation Operating Fund, our projection for Operating Revenues increased $3.7 million, mainly in Parking and Concessions, for higher than anticipated usage. Total Operating Expenses increased $3.9 million, primarily in

Services, including increased Building Maintenance ($1.8 million) and Interfund Fire Protection ($1.3 million). Interest Income was decreased by $469,000 for final rates and cash balances. Interfund Transfer for Operating Reserve decreased $1.6 million for final calculation of FY2011 reserve amount required. Debt service principal and interest was reduced $2.9 million, reflecting actual year-end amounts, compared to prior months estimated amounts. The total changes above caused the transfer to Capital Improvements to increase $4.3 million.

Within the Convention & Entertainment Facilities Operating Fund, we are decreasing our projection for Facility Rentals by $290,000 for fewer events. Our projections for Other Nonoperating Revenues and Transfers to General Fund increased $7.5 million each to reflect the correct accounting for the sale of Lakewood Church. Finally, we increased Interfund Transfers $1 million for construction costs moved to Fund 8611.

Our projection for Parking Management Operating Fund Operating Revenues increased $484,000, mainly for Metered Parking revenue increased for additional credit card remittances received.

Our projection for Combined Utility System Operating Revenues decreased an additional $5.2 million, again mainly due to lower than expected usage by the Water Authorities and commercial customers. We also decreased Operating Expenses by $6.5 million, mainly for Supplies and Contracts costs, related to lower chemical costs, and lower than expected contract utilization. Other Nonoperating revenue decreased $256,000 for lower Medicare Part D reimbursements. Finally, we decreased our projection for Operating Transfers by $22 million mainly for System Debt Service Transfers ($18 million) for utilization of previously reserved cash balances, and Equipment Acquisitions not received in FY2010 ($4 million).

The projection for Stormwater Fund Total Expenditures was basically unchanged, although Other Services decreased $572,000 while Capital Equipment increased $553,000 for vehicles received. Operating Transfers In decreased $384,000 reflecting the final transfer amount 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 June 30, 2010, the ratio of unhedged variable rate debt for each type of outstanding debt was:

General Obligation	10.7%
Combined Utility System	7.3%
Aviation	16.9%
Convention and Entertainment	30.3%

Respectfully submitted,

Ronald C. Green
City Controller

City of Houston, Texas
Quarterly Swap Agreements Disclosure
June 30, 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 twelve months ended June 30, 2010, the City earned $3.4 million in swap revenue for its 2004B swaps and paid $1.7 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 4.13%. 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 $134.9 million on June 30, 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	$ (30,977,000)	A1 /A /A+
JP Morgan Chase	150,000,000	(30,977,000)	Aa1/ AA-/AA-
UBS AG	150,000,000	(72,965,000)	Aa3 /A+ /A+
	$ 653,325,000	$ (134,919,000)	

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, 2010, the average variable rate paid on the underlying tax-exempt bonds was 0.26%, 0.26% lower than the average 0.52% LIBOR-based rate received for the swap. On June 30, 2010, the interest rate in effect for the underlying bonds was 0.26%, 0.31% lower than the 0.57% 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, 2010 the City earned $461,000 in swap revenue for its 2010B swap and paid $1.6 million on the underlying notes. The amount paid includes a fixed component of 1.30%; however the System does not incur facility fees or dealer fees with the 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, was 4.53%.

Fair value. Because interest rates have changed, the swap had an estimated negative fair value of $47.5 million on June 30, 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 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, 2010, the average variable rate paid on the underlying tax-exempt bonds was 0.62%, 0.44% higher than the average 0.18% LIBOR-based rate received for the swap. At June 30, 2010, the overall rate in effect for the underlying bonds, including the fixed spread component, was 1.55%, 1.30% higher than the 0.25% 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.