

November 30, 1999

Honorable Mayor and City Council Members
Houston, Texas:

I am pleased to provide you with the Comprehensive Annual Financial Report (CAFR) of the City of Houston, Texas (City) for the year ended June 30, 1999, including the independent auditors' report. The CAFR was prepared by the City Controller's Office and satisfies my responsibilities under state law. The accuracy of the financial statements together with the completeness and fairness of their presentation are the responsibility of the City's management. The enclosed data is accurate in all material respects and the report has been designed to present fairly the financial position and results of operations of the various fund and account groups of the City in accordance with generally accepted accounting principles (GAAP), as established by the Governmental Accounting Standards Board (GASB).

The CAFR is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, a list of principal City officials, the City's organizational charts for the Office of the Controller and for Houston's city government, and a copy of the Government Financial Officers Association's Certificate of Achievement for Excellence in Financial Reporting for the City's 1998 CAFR. The financial section includes the general purpose financial statements, the combining and individual fund financial statements and schedules, as well as the auditors' report on the general purpose financial statements. The statistical section includes selected financial and demographic information generally presented on a multi-year basis.

The Reporting Entity and Its Services

This report includes all funds and account groups of the City as well as those legally separate organizations for which the City is financially accountable. The City's determination of "financial accountability" is in accordance with Statement No. 14 of the Governmental Accounting Standards Board, *The Financial Reporting Entity*.

The City provides a full range of municipal government services to approximately 1.8 million residents and to an estimated 21 million conventioners and other visitors annually. Municipal services provided include police and fire protection, emergency medical services, pretrial detention services, traffic and municipal courts, water production and distribution, solid waste collection and disposal, sanitary code enforcement, health and human services, building and housing code enforcement, construction and maintenance of streets and certain bridges, traffic signal installation and maintenance, parks and recreation, library, cultural and convention

activities, and operation of three municipal airports, including George Bush Intercontinental Airport.

The City does not operate hospitals, schools, transportation systems, or higher education systems. Special districts and governmental entities with independent taxing authority administer the public hospitals and public schools within the city.

Economic Conditions and Outlook

Houston is well known as the energy capital of the world, but has also attained world-class prominence in other industries due to its tremendous wealth of natural and human resources. A major corporate center, Houston ranks seventh among U.S. metropolitan areas in the number of corporate headquarters of Fortune 500 companies and is headquarters to eighteen of the 1998 *Fortune 100 Fastest Growing Companies*. Leading industries contributing to Houston's economic success include engineering and construction, real estate, aerospace and space commerce, medicine and health care, transportation, biotechnology, computer hardware and software technology, and electronics and telecommunications.

Houston is a center for cultural and performing arts with a 17-block theater district attracting two million people annually. Tourism is a growing industry in Houston. More than twenty-one million people visit Houston each year. Major attractions include the city's Theater District, the annual Houston Livestock Show and Rodeo, sports venues, museums, expansive hotel and convention facilities, and retail centers.

The fourth-largest city in the U.S. and the largest city in Texas, Houston's population exceeds 1.8 million. Seventy consular offices, forty-two foreign chambers of commerce and trade associations and twenty-eight foreign-owned banks from thirteen nations have helped make Houston both an international and a culturally diverse city. Houston's Consolidated Metropolitan Statistical Area (CMSA) is 54% Caucasian, 23% Hispanic, 18% African American, and 5% Asian and other.

Houston has a highly skilled workforce and well-educated populace with almost 25% of adult Houstonians completing four or more years of college, compared with 20.3% nationally. In surveys conducted nationwide over the past decade, Houston has distinguished itself as a city with a positive attitude. Its continued economic growth and international presence reflect this.

Economic Conditions

Houston continues to experience significant prosperity as evidenced by its population growth and economic indicators:

- The population of Houston's Primary Metropolitan Statistical Area (PMSA) exceeded 3.9 million in 1998 as compared to approximately 3.8 million in 1997.
- Houston's appraised property values, prior to any deductions for exemptions, increased from \$73 billion in 1996 to \$83 billion 1999. This is an increase of more than 13%.

- In 1998, per capita income rose 6.3% to an average of \$30,800 and is expected to grow an average of 5% through 2004, according to the University of Houston Center for Public Policy.
- Average annual non-farm payroll employment in the Houston PMSA in 1998 rose by 93,700, or 4.9%, and seasonally adjusted unemployment for 1998 averaged 4.1%, a decrease of 19.0%.
- Houston's economy continues to diversify. In 1981, employment in non-energy dependent sectors was only 15.7% of the economic base. By 1996, employment in these sectors had grown to 45.8% of the economic base and by 1998 it was 48.3%.
- According to the University of Houston Center for Public Policy, Houston's Consumer Price Index increased by 1.2% in fiscal year 1999 as compared to an increase in the national average of 2.0% for the same period. The second quarter 1999 American Chamber of Commerce Researchers Association (ACCRA) Cost of Living Index indicates that Houston's overall after-tax living costs are 5% below the nationwide average, largely due to the City's low housing costs which are 14% below the nationwide average.
- 1998 retail sales reflected an increase of 3.6% over 1997, according to the University of Houston Center for Public Policy.
- Real estate, both commercial and residential, continues to be a strong sector of Houston's economy. In 1998, the City of Houston issued building permits valued at \$3.6 billion, an increase of 47.5% from 1997. Houston's CMSA nonresidential contracts rose 49.4% to \$2.5 billion and residential 52.6% to \$3.1 billion. As of January 1999 there were 1,059 general-purpose buildings with 156.07 million square feet of rentable office space and an additional 4.64 million square feet was under construction.
- In 1998, Houston's airport system set a new record for passenger volume by serving 39.8 million passengers, an increase of 7.5% over 1997.

Outlook

In recent years, Houston benefited from a strong national economy and the local economy's own momentum. A 4.8% growth in jobs in 1997 carried over into 1998 with continued expansion in construction, retail and a variety of personal services. After three years of strong job growth, averaging 3.6% from 1996 through 1998, weak oil markets and a strong dollar have pulled job growth down to a 1.1% annual growth rate since October 1998. However, OPEC members' high level of compliance with the 1999 spring production cuts pushed the price of West Texas Intermediate to more than \$22 per barrel in late August. If this strong oil market holds, if the U.S. economy remains strong, and if international markets continue to recover without further crisis, Houston could easily return to 3% or better employment growth in 2000, according to Bill Gilmer, assistant vice president and senior economist at the Dallas Fed's Houston Branch.

Over the past two decades the City has diversified its business base to become a leading international business center. The North American Free Trade Agreement (NAFTA) has enabled Houston to gain prominence as a hub of international trade. In the future, Houston will benefit from the expansion of the bioscience, medical and healthcare industries, as well as the computer and electronic fields. Overall, the economic output of the Houston area is expected to more than

double over the next twenty-five years. Economic growth is expected to average almost 3% annually, surpassing that of the U.S. and global economies.

Initiatives and Accomplishments

Houston is a culturally diverse international city which is focused on the future and committed to enhancing the quality of life for its citizens. Major initiatives implemented by City leaders over the past year will ensure the continued success of Houston in the 21st century.

Mayor Lee P. Brown and City Controller Sylvia R. Garcia both took office in January 1998 as the City's top two elected officials.

Mayor Brown's initiatives and accomplishments are a reflection of the five guiding principles that are the foundation of his administration. These are as follows:

- Neighborhood Oriented Government
- Opportunities for Youth
- Transportation and Infrastructure
- Economic Development and International Trade
- Continuous Improvement

City Controller Garcia's initiatives and accomplishments are a reflection of the mission of the City Controller's Office, which is to superintend and supervise the fiscal affairs of the City of Houston and to manage and conduct the same as prescribed by the City Charter and the City Code of Ordinances. The City Controller's Office had several significant accomplishments during fiscal year 1999. Some of these accomplishments and initiatives are as follows:

- The City Controller's Office completed performance and compliance audits of several City departments, including one performance audit co-managed with the Mayor's office. These audits identified potential savings of \$42 million to \$75 million. The City Controller's Office plans to continue increasing the Audit Division staff, shifting from full outsourcing to a more balanced approach, and to develop a fully functional audit organization. A more balanced approach will add value to the audit process by increasing its efficiency and effectiveness.
- Advantage 2000, which integrates the City's core business systems for purchasing, personnel, payroll, and financial transactions and reporting, was successfully implemented. The new system prepares the City to enter the next century with up-to-date technology. Initiatives include making full use of these technological tools to improve services by implementing critical system enhancements, designing and implementing a state of the art citywide data warehouse, and streamlining this Office's procedures for contract and payment processes.
- Improved investment and debt management is another achievement of the past year. Active portfolio management has increased the City's investment earnings by approximately \$2 million in comparison with benchmarks. The City Controller's Office will maintain high investment returns consistent with safety and liquidity and will undertake a more

sophisticated approach to managing the arbitrage rebate obligations by more active management of investment alternatives.

Additional exciting changes are occurring throughout the Houston area. Downtown Houston is alive with major revitalization efforts. Bayou Place, a new 155,000 square-foot retail and entertainment complex including a multi-plex cinema, a concert performance hall, trendy restaurants and other venues, is alive and thriving on evenings and weekends. Bayou Place Phase II, a 40,000+ square foot expansion, will open in early 2000. In the summer of 1999, construction began on the Hobby Center for the Performing Arts, the future home of Theater under the Stars and the Humphreys School of Musical Theatre. Scheduled to open in 2002, the \$75 million facility will have two stages with seating capacity for 2,650 and 500 attendees, respectively. Across the street in City Hall, the Greater Houston Convention and Visitors Bureau opened a new Visitor Center. It features area guides and brochures, video kiosks, a theater, and state of the art touch screen computers to guide visitors through accommodations, dining, and other attractions in the city and surrounding area.

Enron Field, the new home of the Houston Astros baseball team, is scheduled to open in April 2000. The \$250 million stadium will seat 42,000 and is expected to attract 2.5 million fans annually. Nearby, a \$155 million, 1,000-room convention center hotel is planned together with an expansion to the George R. Brown Convention Center. Also transforming downtown are new upscale apartments, condominiums and lofts, among them a refurbished Houston landmark, the former Rice Hotel, now known as "The Rice."

One of the most exciting downtown undertakings is Cotswold 2000, a landscape, streetscape, waterscape and parking expansion project. The project is expected to dramatically improve the aesthetics and the pedestrian character at the north end of downtown. Cotswold 2000 planners anticipate that the completed project will become a focal point for entertainment and commerce, attracting downtown residents, tourists and citizens from all over Houston. It will also serve to improve access to and between other downtown attractions such as Bayou Place and Enron Field. Finally, in an effort to improve long-neglected areas near downtown, the City is supporting a multi-million dollar redevelopment of an eighty-block section of the Fourth Ward historical area. Redevelopment will include infrastructure improvements and the construction of several hundred new homes.

The Museum of Fine Arts, Houston (MFAH) anticipates the opening of the Audrey Jones Beck Building in March 2000. The Beck Building will permit the MFAH to exhibit, for the first time, work from the entire encyclopedic collection of world art. The Beck Building will house the museum's collection of European art to 1920 (including the Beck Collection and the Sarah Campbell Blaffer Foundation Collection), American art to 1945, and works on paper. Simultaneously, in the Caroline Wiess Law Building, newly designed installations will showcase African gold and the art of Sub-Saharan Africa, stunning examples of Asian, Oceanic, Native American and Pre-Columbian art, and masterworks of contemporary art.

The Port of Houston has been and continues to be one of the primary catalysts for the future strength and development of not only Harris County, but all of Southeast Texas. The Port is a large and diverse economic entity of private and public terminals, both of which contribute \$7.7 billion annually to the region's economy. Nearly 205,000 jobs depend on cargo moving along the Houston Ship Channel. The Port's productive growth in container traffic has prompted the Port Authority Commission to plan for the development of a new container terminal in southeast

Harris County, the Bayport Terminal Project. The project will provide 28,580 jobs, road improvements, and environmental enhancements.

The Metropolitan Transit Authority of Harris County (METRO), serving 1,281 square miles and operating more than 1,400 buses, set a new ridership record in 1998 by carrying 71.3 million passengers. METRO operates five High Occupancy Vehicle lanes, the largest barrier-separated system in the world. METRO is also contributing to the downtown revitalization effort. It has embarked on a Transit Street Project that will add 1,000 trees and new streetlights with special period streetlights in the historic district and will include repaving and resizing streets and widening sidewalks. METRO's new downtown trolleys serve to reduce lunchtime traffic congestion, assist commuters in accessing less expensive parking and encourage downtown activity. Recently, the METRO Board approved a light rail system for the 7.5 mile Downtown-to-Astrodome Corridor. The \$272 million light rail system – which will traverse Downtown employment centers, colleges and universities, the Theater District, the Texas Medical Center, Hermann Park and the Zoo, the Museum District and the Astrodome – will be complete by the year 2004. In addition to METRO's downtown revitalization efforts, its Millennium Mobility Plan also includes more than \$1 billion for street construction throughout the region for the next 10 years, \$1 billion for upgraded bus service, and more than \$100 million in transit access improvements to the reconstructed Katy Freeway.

Home to many professional sports teams, Houston has been a major player in the national and international sports scene for many years. This year was no exception. In September 1999, Houston honored the three-time world champion Women's National Basketball Association Comets with a parade and rally at City Hall. The Houston Astros Baseball team won the National League's Central Division Championship for the third consecutive year. The City also hosted the Texaco Grand Prix through the streets of downtown. This year was the second year of a six-year contract between the City and Championship Auto Racing Teams (CART). Estimated revenues to the City each year are between \$25 and \$30 million, the equivalent of a major political party national convention.

The National Football League (NFL) is back in Houston. The NFL recently awarded Houston a franchise. The team will begin play in 2002 in a new \$310 million stadium to be constructed next to the Astrodome. Additionally, Houston will host a Super Bowl, the most likely year being 2004.

Houston is competing to achieve yet another first as host to the 2012 Olympics Games. The effort is being spearheaded by the Houston 2012 Foundation, a non-profit organization created for the purpose of bidding to become the U.S. Candidate City for the Olympic Games of the XXX Olympiad in the year 2012. The foundation's efforts are aimed at securing public and private sector support and resources to promote elite amateur sporting events, such as the World Amateur Boxing Championship and the Camino Real Equestrian Events. In addition, the Foundation supports and/or participates in various educational and cultural events throughout the greater Houston area.

Financial Information

Accounting System and Budgetary Control

The Mayor serves as the Chief Executive of the City. The City Controller is the second highest elected official within city government and serves as the City's Chief Financial Officer. The legislative body of the City is the City Council which consists of nine district members and five at-large members. The Mayor, City Controller, and Council Members are limited to three two-year elected terms.

The accounting system of the City is organized and operated on the basis of funds and account groups, each of which is in a separate set of self-balancing accounts which comprise each fund's assets, liabilities, fund balance, revenues and expenses. The accounting and financial reporting policies of the City included in this report conform to GAAP and reporting standards as promulgated by GASB, the American Institute of Certified Public Accountants (AICPA) and other appropriate sources. The financial statements of the General, Special Revenue, Debt Service, Capital Projects, and Expendable Trust Funds are prepared on the modified accrual basis of accounting, whereby revenues are recorded when they become both measurable and available to finance expenditures of the current period. Expenditures are generally recorded when goods or services are received and actual liabilities are incurred and become payable with expendable available financial resources. The financial statements of the Enterprise, Internal Service, and the Fiduciary Pension, Trust and Agency Funds are prepared on the accrual basis of accounting whereby revenues/additions are recorded at the time they are earned and expenses/deductions are recorded when liabilities are incurred. Encumbrance accounting, under which purchase orders, contracts, approved requisitions and other commitments for the expenditure of funds are recorded to reserve that portion of the applicable appropriation. Outstanding encumbrances lapse at year-end. Open encumbrances are then reestablished in the succeeding fiscal year against that fiscal year's appropriations. Encumbrances do not constitute expenditures or liabilities.

The City's management is responsible for establishing and maintaining a system of internal controls designed to provide reasonable, but not absolute, assurance that the assets of the City are protected from loss, theft, or misuse and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and that the evaluation of costs and benefits requires estimates and judgments by management.

As a part of its internal control structure the City is required to adopt a balanced budget each year. Based upon recommendations by the Mayor, City Council adopts an annual budget for the General Fund, Debt Service Fund, and Special Revenue Funds. Exceptions are the Grant Revenue, Health Special and Housing Special Revenue Funds, for which City Council adopts separate operating or program budgets throughout the year. Also based upon the Mayor's recommendations, City Council adopts an annual budget for maintenance and operating expenses, excluding depreciation, debt service, and other capital costs of the proprietary funds, except for the Sports Arena, which is managed under a long-term contract. The City Council also appropriates available resources to authorize expenditures pursuant to those budgets. The City does not budget Capital Projects and other expenditures annually. Instead, City Council authorizes these expenditures through individual appropriation ordinances. No City expenditures may be made without a duly adopted ordinance. City Council can legally appropriate only those amounts of money which the City Controller has previously certified are or will be in the City treasury.

Although the legal level of budgetary control is the departmental level within a fund, the City maintains internal budgetary control at the expenditure category (i.e., Personnel Services, Supplies, Other Services and Capital Outlay). Budget control is primarily managed using an automated encumbrance and accounts payable system.

The City is required to undergo an annual Single Audit in conformity with the provisions of the Single Audit Act and the U. S. Office of Management and Budget Circular A-133, "Audits of State and Local Governments," the State of Texas Uniform Grant Management Standards, and the State of Texas Single Audit Circular. These audits are conducted simultaneously with the City's annual financial statement audit. Information related to these Single Audits, including the schedules of financial assistance, findings and recommendations, and auditors' reports on the internal control structure and compliance with applicable laws and regulations is included in separate Single Audit Reports.

General Government Functions

General Government Revenues

Following is a table of General, Special Revenue, Debt Service, and Capital Projects Funds revenues for fiscal years ended June 30, 1999 and 1998. Revenues increased \$46,008,000 or 3.43% from the \$1,340,239,000 generated in 1998 to \$1,386,247,000 in 1999. The General Fund accounts for all revenues and expenditures which are not restricted, and therefore accounted for, in another fund. Special Revenue Funds account for the proceeds of specific revenues sources other than expendable and nonexpendable trust and capital projects that are restricted to expenditures for special purposes. The Debt Service Fund is used to account for all principal and interest payments on long-term debt other than that issued and serviced by Enterprise Funds. The Capital Projects Fund accounts for all resources used for the acquisition and or construction of capital facilities except those financed by Enterprise Funds. The table on page *xvi* presents a summary of revenues by major function of these funds. The amount and percentage of revenue increases and decreases from fiscal year 1999 to fiscal year 1998 are also shown.

General Government Revenue by Sources (in thousands)

Revenue by Source	FY 1999 Amount	% of Total	FY 1998 Amount	Increase (Decrease) From FY 1998	% Increase (Decrease) From FY 1998
General property taxes	\$503,925	36.35%	\$470,389	\$33,536	7.13%
Sales tax	305,472	22.04%	291,899	13,573	4.65%
Franchise fees	139,475	10.06%	126,201	13,274	10.52%
Other taxes	6,354	0.46%	5,954	400	6.72%
Interfund billings	55,106	3.98%	64,590	(9,484)	-14.68%
Fines and forfeits	53,320	3.85%	48,181	5,139	10.67%
Licenses and permits	30,588	2.21%	29,370	1,218	4.15%
Charges for services	70,634	5.10%	61,745	8,889	14.40%
Interest	18,267	1.32%	19,779	(1,512)	-7.64%
Industrial assessments	18,317	1.32%	23,050	(4,733)	-20.53%
Miscellaneous	18,785	1.36%	30,038	(11,253)	-37.46%
Intergovernmental – grants	165,998	11.97%	168,934	(2,936)	-1.74%
Contributions	6	0.00%	109	(103)	-94.50%
Total	\$1,386,247	100.00%	\$1,340,239	\$46,008	3.43%

The significant overall increase of 3.43%, from \$1,340 million in fiscal year 1998 to \$1,386 million in fiscal year 1999, is due to the general overall positive economic conditions nationally and locally. The increase in taxable assessed value from \$69,459,296,000 in 1998 to \$74,272,625,000 in 1999, due in part to completion of new residential and commercial projects, resulted in property taxes increasing by 7.1%. Sales tax revenues increased 4.6% over fiscal year 1998, partially due to the continuing strong local economic conditions. Additionally, franchise fees increased by \$13.3 million due to a new basis for telephone franchise fees assessment.

Expenditures by Function

The following table presents expenditures for major functions compared to the preceding year:

General Government Expenditures by Major Functions (in thousands)

Function	Amount by Function FY 1999	% of Total	Amount by Function FY 1998	Increase (Decrease) From FY 1998	% Increase (Decrease) From FY 1998
General government	\$89,944	5.63%	\$94,027	\$ (4,083)	-4.34%
Public safety	642,782	40.25%	604,789	37,993	6.28%
Public works	206,542	12.93%	202,473	4,069	2.01%
Health	55,201	3.46%	54,228	973	1.79%
Parks and recreation	56,728	3.55%	56,386	342	0.61%
Library	33,823	2.12%	31,057	2,766	8.91%
Retiree benefits	8,941	0.56%	9,133	(192)	-2.10%
Equipment acquisition and other capital outlay	168,441	10.55%	222,498	(54,057)	-24.30%
Other	35,229	2.21%	31,544	3,685	11.68%
Grants	115,224	7.21%	100,740	14,484	14.38%
Debt service	184,173	11.53%	178,900	5,273	2.95%
Total	<u>\$1,597,028</u>	<u>100.00%</u>	<u>\$1,585,775</u>	<u>\$11,253</u>	<u>0.71%</u>

Expenditures of the General, Special Revenue, Debt Service and Capital Projects Funds increased slightly, less than 1% to \$1,597.2 million in fiscal year 1999 from \$1,585.8 million in fiscal year 1998. Public Safety expenditures increased \$38.0 million due to compensation increases in both the Police and Fire Departments and a modest increase in personnel within the Fire Department. Public Works increased \$4.1 million for street and bridge improvements. The capital outlay decrease of \$54.0 million is due to equipment replacement and new high technology purchase and installation in 1998 that was not repeated in 1999.

Expenditures by Category

These same expenditures are reflected by category in the following table:

General Government Expenditures by Category (in thousands)

<u>Category</u>	<u>FY 1999 Amount</u>	<u>% of Total</u>	<u>FY 1998 Amount</u>	<u>Increase (Decrease) From FY 1998</u>	<u>% Increase (Decrease) From FY 1998</u>
Personnel services	\$886,637	55.52%	\$841,335	45,302	5.38%
Supplies and services	358,110	22.42%	381,599	(23,489)	-6.16%
Capital expenditures	52,761	3.30%	83,053	(30,292)	-36.47%
Grants	115,224	7.21%	100,740	14,484	14.38%
Debt service	184,173	11.53%	178,900	5,273	2.95%
Other	123	0.01%	148	(25)	0.00%
Total	<u>\$1,597,028</u>	<u>100.00%</u>	<u>\$1,585,775</u>	<u>11,253</u>	<u>0.71%</u>

General Government Fund Balances

The fund balance of the General Fund decreased \$6,114 million during fiscal year 1999 to \$107,256 million, which represents 8.8% of total expenditures and operating transfers out.

The Special Revenue Funds fund balances increased \$15 million to \$40 million in fiscal year 1999, up from \$25 million in fiscal year 1998. The largest change occurred due to increases in the Asset Forfeiture Fund (up \$3.5 million), the Parks Special Fund (up \$1.3 million), and the Street and Drainage Maintenance Fund (up \$1.3 million).

The fund balance in the Debt Service Fund does not result from operations but from scheduled interfund transfers in anticipation of debt service payments. The fund balance at June 30, 1999, was \$88.7 million. This amount will cover the first seven months of principal and interest payments due in fiscal year 2000 on tax-supported debt.

The City maintains Capital Projects Funds to account for general government capital improvements funded primarily by general obligation bond proceeds. In fiscal year 1999, the City issued new commercial paper for construction in the amount of \$107.7 million and spent \$132.9 million on general improvements, including \$69 million for streets and bridges. At June 30, 1999, \$62.4 million remained in the Capital Projects Fund for future capital improvements.

Proprietary Fund Types

Enterprise Funds

These funds account for City operations that are financed and operated in a manner similar to private business enterprises, where the cost of providing goods or services to the general public is financed primarily through user charges. The Airport System Fund accounts for operations of the City's airports, George Bush Intercontinental, William P. Hobby and Ellington Field. The Sports Arena Fund accounts for the City's interest in the Compaq Center, a multi-purpose sports arena leased to an independent operator. The Convention & Entertainment Facilities Fund accounts for operations of the City's entertainment centers, including the George R. Brown Convention Center, the Wortham Theater, Bayou Place, and City-owned parking garages. The Water and Sewer System Fund accounts for the production and transmission of water, and the treatment of wastewater in the Houston area. Following is certain comparative data on the enterprise funds.

Airport System Fund - Comparative Data (in thousands)

	<u>FY 1999</u>	<u>FY 1998</u>	<u>% Change Increase (Decrease)</u>
Total revenues	\$ 192,209	\$ 183,953	4.5%
Operating income	22,628	30,839	-26.6%
Net revenues available for debt service	75,003	83,913	-10.6%
Debt service requirement	33,942	34,002	-0.2%
Revenue bond coverage (net revenues available for debt service divided by annual debt service)	X 2.21	X 2.47	-38.0%
Net cash flows from operating activities	\$ 85,559	\$ 82,006	4.3%

Most of the positive increases resulted from increased passenger activity and revenue from an increased concession activity. The Airport System's current liabilities arising from operations and its two-month maintenance and operating reserve are fully funded with cash and investments.

Sports Arena

The Sports Arena Fund accounts for certain net lease revenues from the City's interest in the Compaq Center, a 16,729-seat multi-purpose sports facility. Construction of the facility was financed primarily by conduit debt consisting of first mortgage revenue bonds guaranteed by the operating company. Under the lease agreement, the operator is responsible for the operations of the facility and for principal and interest payments on the bonds. This agreement is for the life of the bonds and does not require any cash contributions from the City. The bonds will be entirely repaid by Fiscal Year 2004.

Convention & Entertainment Facilities Fund – Comparative Data (in thousands)

	<u>FY 1999</u>	<u>FY 1998</u>	<u>% Change Increase (Decrease)</u>
Total revenues	\$ 62,251	\$ 54,155	14.95%
Operating loss	(7,485)	(9,772)	-23.40%
Hotel occupancy tax (non-operating Revenue)	42,459	38,270	10.95%
Net revenues available for debt service	27,197	24,833	9.52%
Debt service requirement	12,058	12,056	0.02%
Revenue bond coverage (net revenues available for debt service divided by annual debt service)	X 2.26	X 2.06	0.49%
Net cash flows from operating activities	\$ 31,269	\$ 31,614	-1.09%

The operating loss does not include non-operating hotel tax revenues, which increased by 10.9%.

Water and Sewer System Fund – Comparative Data (in thousands)

	<u>FY 1999</u>	<u>FY 1998</u>	<u>% Change Increase (Decrease)</u>
Total revenues	\$ 593,460	\$ 587,463	1.02%
Operating income (loss)	133,544	135,197	-1.22%
Net revenues available for debt service	332,650	316,836	4.99%
Debt service requirement	197,909	196,043	0.95%
Revenue bond coverage (net revenues available for debt service divided by annual debt service)	X 1.68	X 1.62	3.70%
Net cash flows from operating activities	\$ 305,138	\$ 346,298	-11.89%

The System’s current liabilities arising from operations are fully funded, and its one-month maintenance and operating reserve is fully funded with cash and investments.

Fiduciary Fund Types

Pension Trust Funds

The Firemen’s Relief and Retirement Fund reports an actuarial accrued liability of \$1,271.4 million. Of this, \$76.0 million is overfunded based on the actuarial value of assets compared to \$55.6 million overfunded in the previous year. The Municipal Employees Pension Plan reports an actuarial accrued liability of \$1,240.1 million. Of that, \$144.5 million is unfunded based on the actuarial value of assets compared to \$185.1 million unfunded in the previous year. The Police Officers Pension Plan reports an actuarial accrued liability of \$1,549.3 million. Of that, \$31.2 million is overfunded based on the actuarial value of assets, compared to \$71.4 million unfunded in the previous year. The City’s contributions to the pension plans are actuarially

determined; the result is contribution rates that, over time, remain level as a percent of payroll. For the Firemen's Pension Plan, however, state law requires the City contribute a minimum of twice the member's contribution.

Risk Management

The City purchases commercial property insurance covering city buildings and contents, including abandoned/vacant facilities and leased locations, business interruption/extra expense coverage for the Aviation and Convention and Entertainment Departments. The City also purchases boiler and machinery insurance to provide coverage for loss caused by mechanical or electrical equipment breakdown, including damage to the equipment, damage to other property of the insured, and damage to property of others. The City is self-insured for its employee health benefit plan, long term disability plan, workers' compensation and third-party liability claims.

Employee Health and Long-Term Disability Benefits

The City accounts for its health care and long-term disability plans in internal service funds with full accrual accounting. As of June 30, 1999, these funds were fully funded for both reported claims and those that were incurred and not yet reported. Provider cost increases for health care benefits absorbed by the City have been controlled at 1%, 2.2%, 1.9%, 2.8%, and 0.3% for the last five years.

Workers' Compensation

The City's workers' compensation program is self-insured. All indemnity medical and expense payments are funded by charge-backs to the operating departments. Costs are funded as payments are made. At June 30, 1999, the unfunded long-term liability for incurred claim costs of the governmental funds was \$25.1 million, compared to \$30.1 million at June 30, 1998. Total liability for all funds increased to \$37.4 million, compared to \$37.3 million last year. Claims costs attributable to the City's enterprise funds are fully funded. Claims paid for the entire workforce were \$17.9 million. The City uses a third party administrator for claims processing and payment services to provide statutory and City enhanced benefits to its employees.

Debt Administration

The City continues to issue commercial paper during the construction period for various capital improvement programs. The commercial paper program remains the most efficient and cost-effective method of initially financing new capital projects until permanent financing is arranged. The program has also helped in reducing the City's arbitrage rebate liability.

The City has refinanced portions of its debt in order to take advantage of lower interest rates that prevailed during the year. Approximately \$37 million in existing general obligation debt was refunded and replaced with lower cost debt with substantial savings to the taxpayers. The City also converted \$572 million dollars of its outstanding commercial paper to long-term fixed interest rate debt.

Cash Management

The City Controller's Office manages the investment of all City funds, except those administered by pension boards or trustees. In meeting that responsibility, the City Controller's Office is governed by the following objectives, in order of priority: safety of principal, liquidity, return on investment, and meeting legal requirements. All of these objectives were satisfied during the past fiscal year.

To maximize efficiency, the City's various funds are pooled for investment purposes. As of June 30, 1999, general pooled investments totaled \$1.2 billion. In addition the City maintains a fund for airport construction and improvements that totaled \$501 million as of June 30, 1999. The general pool had an average yield of 5.63% in 1999, and 5.9% in 1998. Investment results outperformed benchmarks. The City's portfolio earned \$87.5 million in Fiscal Year 1999, compared to \$70.2 million in fiscal year 1998.

Award

The Government Finance Officers Association (GFOA) awarded a *Certificate of Achievement* for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 1998. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of a state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Acknowledgements

The preparation of this report on a timely basis could not have been accomplished without the dedicated services and hard work of a highly qualified staff. The City of Houston has such a staff in the City Controller's Office. Although much of the time and effort in preparation of this report lies in the Financial Reporting Division, they were supported by the other divisions of the Office: Executive, Administration, Information Systems, Operations, Investment and Debt Management, and Audit. I would like to express my appreciation to all the staff of the City Controller's Office, and to the staff of the Finance and Administration Department, Aviation Department, and Public Works and Engineering Department who assisted and contributed to the preparation of this report.

The City Controller's Office also received invaluable assistance and support from many others outside our immediate organization. Within the City of Houston, the accounting staffs of the operating departments and the technical staff of the Information Services Division all played key roles in producing this report. The cover photograph of downtown Houston is courtesy of the Greater Houston Partnership. KPMG LLP was not only our independent auditor, but also served as an invaluable source of information and ideas for improving the way that City finances are

reported. Finally, we acknowledge the Mayor and City Council Members who have consistently supported the City's goal of excellence in all aspects of financial management. Their support is greatly appreciated, and I look forward to working together to continue improving the City's financial condition.

Sylvia R. Garcia
City Controller

Sources:

ACCRA

Federal Reserve Bank of Dallas

Greater Houston Partnership

University of Houston Center for Public Policy