CITY OF HOUSTON

Finance Department

Interoffice

Correspondence

To: Budget and Fiscal Affairs Committee

From: Kelly Dowe, Director
Jennifer Olenick, Division Manager
Finance Department

Date: May 9, 2011

Subject: **Convention and Entertainment Facilities Department HOT and Special Revenue Refunding Bonds, Series 2011**

The purpose of this memorandum is to summarize an upcoming transaction, the City's Convention and Entertainment Facilities Department Hotel Occupancy Tax (HOT) and Special Revenue Refunding Bonds, Series 2011 (the "Series 2011 Bonds"). A specific Request for Council Action will be brought to City Council by mid-June.

The CEFD currently has two relatively significant risk factors in its debt portfolio.

- The first risk factor is a debt reserve fund which is partially funded by an Ambac insurance policy. The parent company of the reserve fund policy is currently in bankruptcy and it is likely that the City will eventually be legally required to replace this policy with an approximately $28 million cash reserve fund within a 12 month time period. While the City is not currently legally required to replace the policy, this risk factor has become a matter of concern for the rating agencies and a potential strain on the future resources of the CEFD.
- The second risk factor is a variable interest rate exposure greater than the City's preferred 20%. The currently outstanding $150 million Series 2001C Bonds are structured as auction rate securities where the interest rates are reset on a weekly basis. Given the current low interest rate environment, these bonds have saved the City a significant amount of money with an interest rate that has averaged about 0.42% over the past 18 months. However, these bonds do expose the CEFD to the risk of rising interest rates. This risk is cited by Moody's rating agency as a major reason for the system receiving a negative outlook.

To mitigate these risk factors the Finance Working Group recommends issuing the Series 2011 Bonds for two primary purposes. The first purpose will be to refinance into a fixed rate $75 million of the $150 million Series 2001C auction rate securities. This will reduce the variable interest rate exposure of the system from 30% to 15%. The second purpose will be to refinance the currently outstanding Series 2001A and 2001B Bonds at lower current market interest rates and to use the resulting savings to cash fund approximately $28 million of the debt reserve fund.

Recommendation

The Finance Working Group recommends that the City proceed with this transaction.