

GENERAL OBLIGATION DEBT SERVICE SUMMARY

The City of Houston General Debt Service Fund (the "Fund") accumulates resources for the principal and interest payments on tax supported debt consisting of: public improvement bonds/refunding bonds, general obligation bonds/refunding bonds, claims and judgment bonds, annexed districts' bonds, Pension Obligation Bonds, certificates of obligation, and general obligation commercial paper notes (the "Obligations"). Payments for arbitrage rebate and administrative fees to administer the debt program (paying agent, lines of credit, rating agencies and other professional services) are also accounted for in the Fund. The budgeted debt service requirements for FY2006 are estimated to be \$250.2 million.

The largest revenue source for the Fund is the General Fund, which transfers a portion of ad valorem taxes (property tax receipts) required for debt service on the Obligations. Within the limits prescribed by law, the City is obligated to assess, levy, and collect annual ad valorem taxes sufficient to pay the principal of and interest on the Obligations. The Constitution of the State of Texas limits the maximum ad valorem tax rate to \$2.50 per \$100 assessed valuation for home-rule cities such as the City of Houston. However, the City Charter has tax rate limitations that are more restrictive than those imposed by the state. The City's tax rate for Fiscal Year 2005 (Tax Year 2004) was reduced to \$0.650 (per \$100 assessed valuation), which consists of \$0.46573 for general purposes and \$0.18427 for debt service. The proposed Fiscal Year 2006 Budget includes a tax rate of \$0.650 (per \$100 assessed valuation) for Fiscal Year 2006 (Tax Year 2005).

The City's current policy states that the annual contribution from the General Fund for general obligation debt service should not exceed 20% of the total General Fund revenues, excluding state and federal grants. The budgeted FY2006 General Fund transfer to pay debt service is approximately 11.01 % of expected General Fund revenues.

The second largest source of funding for the Fund is the City's Combined Utility System (CUS). The Combined Utility System Fund is charged each year to compensate the Debt Service Fund for the cost of paying debt service on certain tax bonds and assumed bonds. The sewer portion of the Water and Sewer System is also charged for debt service payments on certain tax bonds issued for sewer purposes.

Other sources include debt service reimbursement for special financings that vary from year to year. Examples of special financings include the Lake Houston Tax Increment Reinvestment Zone (Lake Houston TIRZ) and the Integrated Case Management System (ICMS) being implemented by Municipal Court System - Administration Department (MCAD) Third party reimbursements are from various parties that have special agreements with the City of Houston. Entities that have entered these agreements with the City include Metro Transit System, Buffalo Bayou Partnership and Texas Medical Center. The City uses various commercial paper programs to initially fund certain projects and reimbursements to retire the appropriate portion of the commercial paper.

Interest earned on construction funds (as a result of bonds issued) may be used as a revenue source to help fund debt service and may also be used for expenditures incurred for administering bond programs.

The FY2006 Annual Financing Plan is presented to outline the anticipated sale of City bonds, certificates and notes for the upcoming fiscal year. It is expected that the City will offer a total ranging from \$1.3 billion to \$1.7 billion, depending on needs and market conditions.

The Obligations are issued in both fixed and variable rate structures. The City's current policy is to maintain up to 20% of the Obligations in a variable rate structure (un-hedged) The City currently issues variable rate commercial paper notes. When the amount of outstanding commercial paper notes reach a level of 20-30% of total outstanding debt, a refunding of commercial paper notes is planned to lock in a portion of the outstanding commercial paper notes at fixed rates to minimize interest rate exposure.

Tax Bonds and Certificates of Obligation

The Obligations issued as fixed rate debt bear interest at average rates, ranging from 2.00% up to 8.5%, which are established at the time of issuance and are based on market rates. The City's policy is to keep the combined weighted average life of the fixed rate debt at or below 12 years. The City issues Tax Bonds to provide for permanent financing through refinancing of commercial paper notes or refund previously issued and outstanding Tax Obligations of the City. The City may also issue Judgment Bonds resulting from lawsuits or legal settlements against the City. Additionally, the City has issued Pension Obligations Bonds in FY2005 and is expected to issue more in FY2006. Pension Obligations are payable from and secured by ad valorem taxes or revenues or both to fund unfunded actuarial accrued liabilities ("UAAL") associated with its pension funds.

The City may also issue Tax Certificates payable from ad valorem taxes and, in some cases, a pledge of certain City revenues for the purpose of paying any contractual obligations. Tax Certificates are issued for special financings and demolition of dangerous buildings.

The budget includes a seven-month reserve for Tax Bonds and Certificates. This reserve covers principal and interest payable in the first seven months of the following fiscal year.

Variable Rate Debt -Commercial Paper Notes

The Obligations issued as variable rate debt bear interest rates that are based on current market rates. The City began issuing variable rate debt in FY1992; however, the City does not currently have any variable rate bonds outstanding. The City's variable rate obligations are composed of commercial paper notes, which are issued under commercial paper programs.

The General Obligation Commercial Paper Program, Series A has been authorized with a current available authorization in the amount of \$219.8 million, which provides for the issuance of voter authorized obligations from the 1991 and 1997 bond elections. The General Obligation Commercial Paper Program, Series B has been authorized with a current available authorization in the amount of \$25.8 million for the issuance of the voter-authorized obligations from the 1991 bond election. The General Obligation Commercial Paper Program, Series D has been authorized with a current available authorization in the amount of \$385 million for the issuance of the voter-authorized obligations from the 2001 bond election. The Series A, B and D programs have been implemented to fund various public improvement projects in the Capital Improvement Plan (the "CIP").

There are two Commercial Paper Programs that are being utilized by the City of Houston that require no voter authorization. The first one is the General Obligation Commercial Paper Program, Series E that is authorized to fund equipment acquisitions and other special permanent improvement projects with a current available authorization in the amount of \$155 million. The City authorized a second program, which is Series F General Obligation Commercial Paper Program with a total available authorization of \$139.5 million to fund certain capital improvements related to drainage.

The commercial paper programs serve as a management tool to access the credit market to meet cash needs to effect less rebate liability on unspent proceeds. The commercial paper notes are refunded to fixed rate tax bonds periodically to limit the City's variable rate exposure and to match the average life of bonds to the life of the assets purchased. Interest on the notes varies periodically. The notes may be issued for a period not to exceed 270 days and will bear interest based upon the specified terms, but initially not to exceed six and one-half percent. The reserves for the notes are based on the amount projected to be outstanding during the fiscal year. For FY2005, average all-in interest cost for variable rate obligations was approximately 2.50%. The budgeted all-in interest cost for the City's variable rate obligations in FY2006 is 3.75%. The budget includes reserves for interest on commercial paper notes to provide for fluctuations in interest rates at a rate of 5.60% of the estimated amount to be outstanding during the fiscal year.

Assumed Bonds

Prior to FY1991, the City had an aggressive annexation program. However, no annexations took place during FY1991 and FY1992 until the period from FY1993 to FY1997 in which the City completed seven new annexations. Although annexations have benefited the City in economic growth, no additional annexations have occurred since FY1997. Recently approved legislation requires the City to adopt a three-year annexation plan, and with certain exceptions, only those areas identified in such plan would be eligible for annexation. The City does not currently have a plan in place to annex additional districts. Debt assumed by the City from annexations of various districts within the extra-territorial jurisdiction becomes a part of the City's debt service requirements.

Interest Rate Swaps

As part of its debt management program, the City, consistent with the guidelines set forth in its interest rate swap policy adopted on November 25, 2003, considers and reviews various interest rate swap proposals, including tax supported interest rate swaps. On February 20, 2004, with respect to certain outstanding Tax Bonds, the City entered into a tax supported interest rate swap agreement with Rice Financial Products Corp. LLC. The City will pay a variable rate and receive a fixed rate of return on a notional principal value of \$200,000,000, with the underlying bonds being various maturities of Public Improvement Bonds (PIB) issued between 1998 and 2002.

Principal and Interest Payable from Ad Valorem Taxes

| Fiscal Year | Tax Bonds | | Pension Obligations | | Tax Certificates | |
|-------------|----------------------|--------------------|---------------------|--------------------|-------------------|-------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2006 | 116,270,000 | 84,929,513 | | 25,528,438 | 3,500,000 | 1,130,586 |
| 2007 | 124,350,000 | 78,636,360 | | 28,535,462 | 1,075,000 | 987,086 |
| 2008 | 132,720,000 | 71,628,223 | | 28,535,462 | 1,645,000 | 944,086 |
| 2009 | 131,955,000 | 64,234,035 | | 28,535,462 | 3,390,000 | 873,986 |
| 2010 | 129,260,000 | 57,523,925 | | 28,535,462 | 1,230,000 | 755,511 |
| 2011 | 120,840,000 | 50,991,594 | | 28,535,462 | 5,512,886 | 4,279,738 |
| 2012 | 114,180,000 | 44,785,356 | | 28,535,462 | 630,000 | 651,489 |
| 2013 | 94,975,000 | 38,996,231 | | 28,535,462 | 655,000 | 627,549 |
| 2014 | 81,745,000 | 34,042,488 | | 28,535,462 | 680,000 | 602,004 |
| 2015 | 77,350,000 | 29,760,519 | | 28,535,462 | 710,000 | 574,124 |
| 2016 | 79,710,000 | 25,635,588 | | 28,535,462 | 740,000 | 544,304 |
| 2017 | 78,460,000 | 21,389,600 | | 28,535,462 | 1,690,000 | 512,484 |
| 2018 | 78,795,000 | 17,217,419 | | 28,535,462 | 1,775,000 | 426,915 |
| 2019 | 48,670,000 | 13,024,300 | | 28,535,462 | 1,860,000 | 340,285 |
| 2020 | 44,520,000 | 10,499,575 | | 28,535,462 | 1,955,000 | 248,635 |
| 2021 | 42,555,000 | 8,239,788 | | 28,535,462 | 2,050,000 | 151,400 |
| 2022 | 44,700,000 | 6,097,525 | | 28,535,462 | 970,000 | 48,500 |
| 2023 | 46,950,000 | 3,847,250 | | 28,535,462 | | |
| 2024 | 22,910,000 | 1,499,750 | | 28,535,462 | | |
| 2025 | 7,085,000 | 354,250 | | 28,535,462 | | |
| 2026 | | | | 28,535,462 | | |
| 2027 | | | | 28,535,462 | | |
| 2028 | | | | 28,535,462 | | |
| 2029 | | | 8,340,000 | 28,535,462 | | |
| 2030 | | | 8,780,000 | 28,092,608 | | |
| 2031 | | | 9,250,000 | 27,626,390 | | |
| 2032 | | | 9,740,000 | 27,135,215 | | |
| 2033 | | | 10,255,000 | 26,618,021 | | |
| 2034 | | | 300,000,000 | 26,073,480 | | |
| 2035 | | | 10,800,000 | 573,480 | | |
| | <u>1,618,000,000</u> | <u>663,333,286</u> | <u>357,165,000</u> | <u>817,963,245</u> | <u>30,067,886</u> | <u>13,698,682</u> |

FISCAL YEAR 2006 BUDGET

| Assumed Bonds | | Total |
|---------------|-----------|---------------|
| Principal | Interest | Debt Service |
| 815,000 | 559,559 | 232,733,096 |
| 860,000 | 516,736 | 234,960,644 |
| 900,000 | 472,351 | 236,845,122 |
| 875,000 | 428,821 | 230,292,304 |
| 940,000 | 383,000 | 218,627,898 |
| 885,000 | 336,963 | 211,381,641 |
| 745,000 | 296,503 | 189,823,809 |
| 665,000 | 263,236 | 164,717,478 |
| 775,000 | 232,070 | 146,612,023 |
| 990,000 | 190,763 | 138,110,867 |
| 1,040,000 | 142,795 | 136,348,148 |
| 1,090,000 | 92,298 | 131,769,843 |
| 550,000 | 41,480 | 127,341,275 |
| 0 | 28,600 | 92,458,647 |
| 160,000 | 24,200 | 85,942,872 |
| 175,000 | 14,988 | 81,721,637 |
| 185,000 | 5,088 | 80,541,574 |
| | | 79,332,712 |
| | | 52,945,212 |
| | | 35,974,712 |
| | | 28,535,462 |
| | | 28,535,462 |
| | | 28,535,462 |
| | | 36,875,462 |
| | | 36,872,608 |
| | | 36,876,390 |
| | | 36,875,215 |
| | | 36,873,021 |
| | | 326,073,480 |
| | | 11,373,480 |
| 11,650,000 | 4,029,449 | 3,515,907,547 |

Ad Valorem Tax Obligations of the City

State law permits the City to incur total bonded indebtedness through the issuance of voter authorized ad valorem tax bonds in an amount not to exceed 10% of the total assessed valuation of property in the City. The schedule below shows an estimate for the current fiscal year of outstanding debt applicable to the statutory limitation.

(Amounts expressed in thousands)

| | | |
|---|-----------------|----------------------|
| Assessed Value (1) | | <u>\$105,859,805</u> |
| Debt Limit, 10% of Assessed Value | | \$10,585,981 |
| Public Improvement Bonds | 1,624,290 | |
| Commercial Paper Notes | 404,200 | |
| Pension Obligation Bonds | 380,065 | |
| Judgment Bonds | 0 | |
| Certificates of Obligation | 30,068 | |
| Annexed Districts' Bonds | <u>11,650</u> | |
| Total | 2,450,273 | |
| Less: | | |
| Amount available for repayment of general obligation debt (2) | <u>(96,203)</u> | |
| Total debt applicable to limitation | | <u>2,354,070</u> |
| Legal debt margin | | <u>\$8,231,911</u> |

(1) Assessed value for the Fiscal Year 2005 (2004 tax year), as of **April 30, 2004**, based on the appraised Value of property prior to any deductions.

(2) Estimated fund balance for fiscal year ending June 30, 2005.

Outstanding General Obligation Debt

| (In thousands of dollars) | <u>FY2003</u> Actual | <u>FY2004</u> Actual | <u>FY2005</u> Estimate | <u>FY2006</u> Budget |
|----------------------------|-------------------------|-------------------------|---------------------------|-------------------------|
| OUTSTANDING DEBT: | | | | |
| Public Improvement Bonds | \$ 1,502,635 | \$ 1,556,435 | \$ 1,624,290 | \$ 1,618,000 |
| Commercial Paper Notes | 415,300 | 427,800 | 404,200 | 584,900 |
| Pension Obligation Bonds | 0 | 0 | 380,065 | 357,165 |
| Judgment Bonds | 2,365 | 1,365 | 0 | 0 |
| Certificates of Obligation | 39,529 | 33,519 | 30,068 | 30,068 |
| Annexed Districts' Bonds | 42,532 | 12,420 | 11,650 | 11,650 |
| TOTAL OUTSTANDING DEBT | <u>\$ 2,002,361</u> | <u>2,031,539</u> | <u>2,450,273</u> | <u>\$ 2,601,783</u> |

The strength of the City's general obligation debt is reflected in the statements of the ratings agencies:
Standard & Poor's (AA-) "Reflected in the rating is management's commitment to control expenditure growth and deal with the City's significant contingent liabilities and also sizable, deep and diversified economic base."
Moody's (Aa3) - "The rating reflects Moody's outlook that the City of Houston is stable considering recent financial improvement and changes."
Fitch's (AA-)"The rating reflects a resilient broad economy, a moderate direct debt burden and adequate general fund reserves".