GENERAL OBLIGATION DEBT SERVICE SUMMARY

The City of Houston General Debt Service Fund (the "Fund") accumulates resources for the interest and principal payments on tax supported debt consisting of: public improvement bonds/refunding bonds, general obligation bonds/refunding bonds, claims and judgment bonds, annexed districts' 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 FY2004 are estimated to be $215.5million.

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. A voter-approved 1982 amendment to the City's home-rule charter limits the tax rate for general purposes to $0.50 (per $100 of assessed valuation) but does not limit the taxes to be levied for debt service on the Obligations. The tax rate for FY2003 (Tax Year 2002) was $0.655 (per $100 of assessed valuation), which consists of $0.47459 for general purposes and $0.18041 for debt service. A tax rate of $0.655 is budgeted for FY2004 (Tax Year 2003).

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 FY2004 General Fund transfer to pay debt service is approximately 11.6% of expected General Fund revenues.

The second largest source of funding for the Fund is the City's Water and Sewer System Revenue Fund. The Water and Sewer System Revenue Fund is charged each year to compensate the 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.

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 FY2004 Annual Financing Plan is presented to outline the sale of City bonds, certificates and notes for the fiscal year. It is expected that the City will offer a total ranging from $800 million to $1.2 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) to lower overall debt service cost. 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 3.20% up to 7.00%, 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. Certificates of Obligation are issued to fund the demolition of dangerous building and other special financings.

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 include 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 $348 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 $100 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 $165 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").

The $100 million General Obligation Commercial Paper Program, Series C has been authorized to fund equipment acquisitions and certain special permanent improvement projects. The state law authorizing the Series C Program only allows for a seven-year life. As a result, $60 million of the Series C Program (authorized November 6, 1996) is due to expire in November 2003 and the remaining $40 million (authorized June 4, 1997) is due to expire in June 2004. As such, a new General Obligation Commercial Paper Program, Series E has been authorized to fund equipment acquisitions and other special permanent improvement projects with a current available authorization in the amount of $75 million.

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 FY2003, average all-in interest cost for variable rate obligations was approximately 1.50%. The budgeted all-in interest costs for the City's variable rate obligations in FY2003 is 2.75%.

The budget includes reserves for interest on commercial paper notes to provide for fluctuations in interest rates at a rate of 3.75% 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.