

## GENERAL OBLIGATION DEBT SERVICE SUMMARY

The City of Houston's General Debt Service Fund (the "Fund") accumulates resources for the principal and interest payments on tax supported debt consisting of: general obligation bonds/refunding bonds, claims and judgment bonds, annexed districts' bonds, pension 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 debt service requirements for FY2010 are estimated to be \$305 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 (the "City"). 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 2009 (Tax Year 2008) was \$0.64375 (per \$100 assessed valuation), which consists of \$0.454603 for general purposes and \$0.184147 for debt service. The proposed Fiscal Year 2010 Budget includes a tax rate of \$0.63875 (per \$100 assessed valuation) for Fiscal Year 2010 (Tax Year 2009).

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 FY2010 General Fund transfer to pay debt service is approximately 14.06% of expected General Fund revenues.

The second largest source of revenue for the Fund are annual charges to the Combined Utility System Fund 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 Combined Utility System is also charged for debt service payments on certain tax bonds issued for sewer purposes.

Another source of revenue for the Fund is third party reimbursements. Third party reimbursements are from various parties that have special agreements with the City. Entities that have entered into these agreements with the City include but are not limited to the Metro Transit Authority of Harris County, Buffalo Bayou Partnership, Texas Medical Center and Federal Emergency Management Agency (FEMA). The City uses various commercial paper programs to initially fund certain projects but receives reimbursements to retire the appropriate portion of the commercial paper.

Other sources include but are not limited to 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 lighting retrofit projects being implemented by the General Services Department (GSD). 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 FY2010 Annual Financing Plan is presented to outline the anticipated sale of City bonds, certificates of obligations, pension bonds, tax and revenue anticipation notes and commercial paper notes for the upcoming fiscal year. It is expected that the City will issue a total ranging from \$1.2 billion to \$1.9 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 approximately 20% of the Obligations in a variable rate structure. The City currently issues variable rate commercial paper notes to initially fund various projects. When the amount of outstanding commercial paper notes reaches a level of 20% 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.

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Tax Bonds and Certificates of Obligation

The Obligations issued as fixed rate debt bear interest rates ranging from 2.00% 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 or refund previously issued and outstanding Tax Obligations of the City. The City has issued Pension Obligation Bonds in FY2005, FY2006, FY2007, FY2008, FY2009 and is expected to issue more in FY2010. Pension Obligations Bonds are payable from and secured by ad valorem taxes and/or revenues to fund unfunded actuarial accrued liabilities ("UAAL") associated with its pension funds.

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

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

Variable Rate Debt -Commercial Paper Notes

The General Obligation Commercial Paper Program, Series D ("Series D") has total available authorization of \$375 million and General Obligation Commercial Paper Program, Series G ("Series G") has total available authorization in the amount of \$276 million. Series D and Series G provides for the issuance of voter-authorized obligations related to the 2001 and 2006 bond elections and both series have been implemented to fund various public improvement projects in the Capital Improvement Plan (the "CIP").

The City authorized General Obligation Commercial Paper Program, Series E ("Series E") with a current total available authorization of \$375 million, \$50 million of which is authorized for less than one year, under Chapter 1431, Texas Government Code, as amended (voter authorization not required). The City authorized General Obligation Commercial Paper Program, Series F ("Series F ") with a total available authorization of \$139.5 million under Chapter 1431, Texas Government Code, as amended (voter authorization not required) to fund certain capital improvements related to drainage.

The City authorized General Obligation Commercial Paper Program, Series H ("Series H") with a total capacity of \$200 million. The Series H Notes is a supplement to the Series D, Series G, and Series F Notes but is not an increase of total authorization.

The commercial paper programs serve as a management tool to access the credit market to meet cash needs while minimizing the rebate liability on unspent proceeds. The commercial paper notes are refunded periodically to fixed rate tax bonds 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 depending on the market conditions. 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 FY2009, average all-in interest cost for variable rate obligations was approximately 2.2%. The budgeted all-in interest cost for the City's variable rate obligations in FY2010 is 3.0%. The budget includes reserves for interest on commercial paper notes to provide for fluctuations in interest rates at a rate of 6.0% 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 during which the City completed seven new annexations. Although annexations have benefited the City in economic growth, no additional annexations have occurred since FY1997. Since FY1999 the legislation requires the City to adopt a

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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. During Fiscal Year 2007 all the debt related to annexation has been refunded.

Interest Rate Swaps

As part of its debt management program, the City considers and reviews various interest rate swap proposals, including tax supported interest rate swaps, consistent with the guidelines set forth in its Interest Rate Swap Policy adopted on November 25, 2003. 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 (RFP). Under this Swap Agreement, the counter party (RFP) effectively pays a variable interest rate based on a LIBOR rate plus a fixed spread, and the City pays a variable interest rate, based on a tax exempt rate, SIFMA (formerly BMA), times a notional principal amount equal to \$200 million. The underlying bonds are Public Improvement Bonds (PIB) issued between 1998 and 2005 with various maturities. The initial payment date was March 1, 2005, and thereafter payments continue every September 1 and March 1 through the maturity on March 1, 2025.

Drainage Supplemental Debt Service Fund

In FY2009 City Council instituted the Drainage Supplemental Debt Service Fund for the purpose of funding additional long-term drainage initiatives. The program calls for an annual set aside of a pre-determined portion of ad valorem tax receipts, as approved by Council annually. The proposed set-aside amount is equal to \$0.0035 per \$100 of ad valorem tax valuation for FY2010.

**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 appraised 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.

(in thousands of dollars)

|   |                  |                      |
|---|------------------|----------------------|
| Appraised Value (1)   |                  | <u>\$195,056,751</u> |
| Debt Limit, 10% of Appraised Value                            |                  | \$ 19,505,675        |
| Debt applicable to limitation (2)                             |                  |                      |
| Public Improvement Bonds                                      | \$1,988,300      |                      |
| Commercial Paper Notes  | 483,045          |                      |
| Pension Obligation  | 587,525          |                      |
| Certificates of Obligation                                    | <u>82,833</u>    |                      |
| Total Debt Applicable to Limitation                           | \$3,141,703      |                      |
| Less:   |                  |                      |
| Amount available for repayment of general obligation debt (2) | <u>(155,000)</u> |                      |
| Total debt applicable to limitation                           |                  | <u>\$ 2,986,703</u>  |

(1) Appraised value for the Fiscal Year 2009 (2008-tax year), as of April 17, 2009.

(2) Estimated fund balance for fiscal year ending June 30, 2009.

**Outstanding General Obligation Debt**

(in thousands of dollars)

|                            | FY2007             | FY2008             | FY2009             | FY2010             |
|----------------------------|--------------------|--------------------|--------------------|--------------------|
|                            | Actual             | Actual             | Estimate           | Budget             |
| OUTSTANDING DEBT:          |                    |                    |                    |                    |
| Public Improvement Bonds   | \$1,760,090        | \$1,798,150        | \$1,988,300        | \$2,247,765        |
| Commercial Paper Notes     | \$ 521,100         | \$ 625,950         | \$ 483,045         | \$ 343,000         |
| Pension Obligation         | \$ 515,933         | \$ 567,481         | \$ 587,525         | \$ 602,525         |
| Certificates of Obligation | \$ 82,351          | \$ 88,875          | \$ 82,833          | \$ 98,443          |
| Annexed Districts' Bonds   | \$ -               | \$ -               | \$ -               | \$ -               |
| TOTAL OUTSTANDING DEBT     | <u>\$2,879,474</u> | <u>\$3,080,456</u> | <u>\$3,141,703</u> | <u>\$3,291,733</u> |

The strength of the City's general obligation debt is reflected in the statements of the ratings agencies:  
**Standard & Poor's (AA)** The stable outlook reflects the city's improving economic activity, coupled with renewed employment growth and continued diversification away from the historically concentrated oil- and gas- related industries."

**Moody's (Aa3)** - "The rating reflects the city's sizable tax base that continues to diversify, a moderate debt burden, narrowed, yet adequate, financial position."

**Fitch** - "The 'AA-' rating reflects the growth in tax base values, the diversifying economy, moderate direct debt burden, and improving financial margin of the general fund."

## Principal and Interest Payable from Ad Valorem Taxes

Existing debt service as of April 21, 2009

| <u>Fiscal</u><br><u>Year</u> | <u>Tax Bonds</u>     |                    | <u>Pension Obligations</u> |                    |
|------------------------------|----------------------|--------------------|----------------------------|--------------------|
|                              | <u>Principal</u>     | <u>Interest</u>    | <u>Principal</u>           | <u>Interest</u>    |
| 2010                         | 133,785,000          | 100,697,568        | -                          | 35,416,883         |
| 2011                         | 131,765,000          | 93,972,436         | -                          | 35,416,883         |
| 2012                         | 130,640,000          | 87,248,861         | -                          | 35,416,883         |
| 2013                         | 125,665,000          | 80,731,474         | -                          | 35,416,883         |
| 2014                         | 118,275,000          | 74,332,230         | 6,345,000                  | 35,416,883         |
| 2015                         | 127,380,000          | 68,353,993         | 6,790,000                  | 35,017,782         |
| 2016                         | 134,595,000          | 61,788,936         | 7,265,000                  | 34,590,691         |
| 2017                         | 130,495,000          | 54,917,311         | 7,770,000                  | 34,133,723         |
| 2018                         | 132,755,000          | 48,295,399         | 8,315,000                  | 33,644,990         |
| 2019                         | 108,510,000          | 41,528,288         | 8,895,000                  | 33,121,976         |
| 2020                         | 107,160,000          | 36,100,138         | 9,520,000                  | 32,562,481         |
| 2021                         | 87,290,000           | 30,740,150         | 20,145,000                 | 31,963,673         |
| 2022                         | 99,715,000           | 26,342,288         | 21,440,000                 | 30,696,552         |
| 2023                         | 110,575,000          | 21,324,688         | 22,805,000                 | 29,347,976         |
| 2024                         | 59,245,000           | 15,795,938         | 24,265,000                 | 27,913,542         |
| 2025                         | 61,285,000           | 12,828,363         | 25,820,000                 | 26,387,273         |
| 2026                         | 26,100,000           | 9,678,213          | 27,475,000                 | 24,763,195         |
| 2027                         | 44,120,000           | 8,373,213          | 29,235,000                 | 23,035,018         |
| 2028                         | 41,170,000           | 6,095,513          | 31,100,000                 | 21,196,136         |
| 2029                         | 6,390,000            | 3,945,138          | 41,425,000                 | 19,239,946         |
| 2030                         | 6,710,000            | 3,619,075          | 43,995,000                 | 16,716,046         |
| 2031                         | 7,060,000            | 3,276,656          | 58,135,000                 | 14,034,804         |
| 2032                         | 9,875,000            | 2,916,363          | 61,650,000                 | 10,558,028         |
| 2033                         | 10,375,000           | 2,418,656          | 22,965,000                 | 6,869,887          |
| 2034                         | 8,180,000            | 1,895,700          | -                          | 5,625,280          |
| 2035                         | 11,310,000           | 1,485,619          | 44,345,000                 | 5,625,280          |
| 2036                         | 9,020,000            | 915,538            | 35,400,000                 | 3,198,102          |
| 2037                         | 6,050,000            | 463,244            | 22,425,000                 | 1,241,897          |
| 2038                         | 2,805,000            | 150,769            |                            |                    |
|                              | <b>1,988,300,000</b> | <b>900,231,751</b> | <b>587,525,000</b>         | <b>678,568,690</b> |

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FISCAL YEAR 2010 BUDGET

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| Tax Certificates  |                   | Total                |
|-------------------|-------------------|----------------------|
| Principal         | Interest          | Debt Service         |
| 6,917,250         | 3,683,518         | 280,500,218          |
| 6,484,998         | 3,398,880         | 271,038,197          |
| 6,250,000         | 3,268,870         | 262,824,614          |
| 11,095,000        | 2,984,380         | 255,892,736          |
| 2,890,000         | 2,458,085         | 239,717,198          |
| 3,010,000         | 2,341,805         | 242,893,580          |
| 3,155,000         | 2,196,985         | 243,591,612          |
| 3,310,000         | 2,044,415         | 232,670,449          |
| 3,470,000         | 1,883,565         | 228,363,953          |
| 3,640,000         | 1,714,115         | 197,409,379          |
| 3,820,000         | 1,535,495         | 190,698,113          |
| 4,005,000         | 1,347,150         | 175,490,973          |
| 4,205,000         | 1,148,750         | 183,547,590          |
| 3,395,000         | 938,500           | 188,386,164          |
| 3,565,000         | 768,750           | 131,553,229          |
| 3,745,000         | 590,500           | 130,656,136          |
| 3,935,000         | 403,250           | 92,354,658           |
| 4,130,000         | 206,500           | 109,099,730          |
|                   |                   | 99,561,649           |
|                   |                   | 71,000,084           |
|                   |                   | 71,040,121           |
|                   |                   | 82,506,460           |
|                   |                   | 84,999,391           |
|                   |                   | 42,628,543           |
|                   |                   | 15,700,980           |
|                   |                   | 62,765,898           |
|                   |                   | 48,533,640           |
|                   |                   | 30,180,140           |
|                   |                   | 2,955,769            |
| <b>81,022,249</b> | <b>32,913,513</b> | <b>4,268,561,203</b> |