

GENERAL OBLIGATION DEBT SERVICE SUMMARY

General Obligation debt is secured by and payable from the receipts of annual ad valorem taxes, within legal limits, on taxable property within the City. The City has covenanted to assess, levy and collect an ad valorem tax in each calendar year, within applicable limitations, sufficient to pay the principal of and interest on all outstanding obligations payable in such tax year. Such obligations include (1) Public Improvement Bonds, (ii) Certificates of Obligation, (iii) Certain obligations to fund a portion of the City's unfunded actuarially accrued liability to the City's pension programs, and (iv) General obligation commercial paper notes. The debt service requirements for FY2015 are estimated to be \$343 million.

The largest revenue source for the General Debt Service Funds 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"). In addition, Proposition 1 limits increases in the City's ad valorem tax revenues by requiring voter approval for increases in ad valorem taxes in future years above a limit equal to the lesser of the actual revenues in the proceeding Fiscal year, plus 4.5%, or a formula that is based upon the actual revenues received in Fiscal Year 2005 adjusted for the cumulative combined rate of inflation and the City's population growth. In addition, in November 2006, Proposition H was passed to further increase the applicable revenue limitations by \$90 million. The City's tax rate for Fiscal Year 2014 (tax year 2013) was \$0.63875 (per \$100 assessed valuation), which consists of \$0.477085 for general purposes and \$0.161665 for debt service. The proposed Fiscal Year 2015 Budget includes a tax rate of \$0.63875 (per \$100 assessed valuation) for Fiscal Year 2015 (tax year 2014).

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 FY2015 General Fund transfer to pay debt service is approximately 12.5% of expected General Fund revenues.

The second largest source of revenue for the Fund are annual charges to the Combined Utility System to compensate the Debt Service Fund for the cost of paying debt service on assumed annexed water district debt. The Combined Utility System, via the Storm Water Fund, is also charged for debt service payments on certain tax bonds issued for storm water purposes.

In past years, another source of revenue for the Fund was third party reimbursements, which primarily consisted of the Metro Transit Authority of Harris County (METRO). The City used various commercial paper programs to initially fund certain projects and then received reimbursements to retire the appropriate portion of the commercial paper. The City is still participating with METRO to complete certain projects; however, there is a new agreement for METRO to provide the funds before project initiation, rather than as a reimbursement. Therefore, going forward, funding from METRO will primarily be a source of revenue for the Capital Projects Funds.

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 projects managed by the City but funded by Tax Increment Reinvestment Zones (TIRZ). 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 FY2015 Annual Financing Plan is presented to outline the anticipated sale of City bonds, certificates of obligation, 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 \$50 million to \$1.6 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 no more than 20% of the obligations in a variable rate structure and 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, or is otherwise deemed prudent, the commercial paper notes are

refunded with fixed rate bonds 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 yields ranging from 0.20% up to 6.29%, 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 refunding of commercial paper notes or refunding previously issued and outstanding Tax Obligations of the City. The City issued Pension Obligation Bonds in FY2005 - FY2010 and is not expected to issue more in FY2015. 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 demolitions 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

Commercial paper programs provide for the issuance of voter-authorized obligations related to the 2001, 2006 and 2012 bond elections and these series have been implemented to fund various public improvement projects in the Capital Improvement Plan (CIP). These commercial paper programs include the:

- Series G with a total authorization of \$200 million,
- Series H with a total authorization of \$100 million, and
- Series J with a total authorization of \$125 million.

The City has also authorized two other commercial paper programs under Chapter 1431, Texas Government Code, as amended, which does not require voter authorization. These programs and their uses are:

- Series E with a total authorization of \$200 million is used to fund equipment acquisitions, and
- Series K with a total authorization of \$200 million is used to provide appropriation capacity to fund capital improvements related to drainage and streets.

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 into 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 6.5%. The reserves for the notes are based on the amount projected to be outstanding during the fiscal year. 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 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. As of FY2007, all of 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). This swap was terminated at the City's option on August 25, 2009. An accumulated profit of approximately \$8 million was earned on this swap. No swaps are being contemplated at this time.

Rebuild Houston

On November 2, 2010, voters approved an amendment to the City Charter which requires the City to establish a dedicated pay-as-you-go drainage and street renewal fund to provide for enhancement, improvement and ongoing renewal of the City's drainage and streets. Among other sources of funding, Proposition 1 (2010) requires the City to capture an amount equal to revenues from 11.8 cents per \$100 of assessed valuation in property taxes. This revenue has two authorized uses under Proposition 1. First, the 11.8 cents of captured property tax revenue must be used to pay debt service on tax supported bonds for drainage and street improvements that were issued prior to December 31, 2011. Second, to the extent that any of the 11.8 cents of captured property tax revenue is left over after the payment of debt service, that remaining captured tax revenue will be deposited into a dedicated drainage and street improvement fund to provide cash funding for pay-as-you-go drainage and street improvements.

Ad Valorem Tax Obligations of the City

State law permits the City to incur total bonded indebtedness through the issuance of 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>219,931,314</u>
Debt Limit, 10% of Appraised Value	\$ 21,993,131
Debt applicable to limitation (2)	
Public Improvement Bonds	\$2,422,445
Commercial Paper Notes	212,350
Pension Obligation	601,430
Certificates of Obligation	<u>18,660</u>
Total Debt Applicable to Limitation	\$3,254,885
Less:	
Amount available for repayment of general obligation debt (2)	<u>(156,516)</u>
Total debt applicable to limitation	<u>\$ 3,098,369</u>

(1) Appraised value for the Fiscal Year 2014 (Tax Year 2013), as of March 7, 2014.

(2) Balance as of March 31, 2014.

Outstanding General Obligation Debt

(in thousands of dollars)

	FY2012	FY2013	FY2014	FY2015
	Actual	Actual	Estimate	Budget
OUTSTANDING DEBT:				
Public Improvement Bonds	\$2,582,320	\$2,561,515	\$2,572,445	\$2,424,340
Commercial Paper Notes	\$ 226,900	\$ 176,900	\$ 62,350	\$ 159,150
Pension Obligation	\$ 607,775	\$ 607,775	\$ 601,430	\$ 594,640
Certificates of Obligation	\$ 17,365	\$ 11,870	\$ 25,660	\$ 22,576
TOTAL OUTSTANDING DEBT	<u>\$3,434,360</u>	<u>\$3,358,060</u>	<u>\$3,261,885</u>	<u>\$3,200,706</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 our expectation that officials will continue to take steps necessary to manage the city's financial position in compliance with the formal reserve policy. While we do not expect the rating to change within the next two years, the rating could be lowered if revenues were to decline significantly due to a weaker-than-expected economy or if pension funding expenditures were to increase, and if the city did not take the steps to mitigate the impact on its financial position. While we are unlikely to raise the rating in the foreseeable future, the rating could be raised if debt levels moderate and the city addresses its unfunded pension obligation, and if budgetary flexibility improves to levels we consider very strong.

Moody's (Aa2) - "The rating reflects the city's large taxbase that is expected to have stabilized in fiscal 2012, a financial position that remains adequate following significant draw downs in fiscal 2010 and 2011 and an above average yet manageable debt burden. The stable outlook reflects Moody's expectation that 2011 reflects a low point and that the trend of narrowing reserves will be reversed in 2012 following improving economic conditions and management commitment to improving financial margins."

Fitch (AA) - Key rating drivers include improved operations; large benefit liabilities; a large, diverse regional economy; and budget pressures to continue.

Principal and Interest Payable from Ad Valorem Taxes

Existing debt as of April 25, 2014

Fiscal Year	Tax Bonds		Pension Obligations	
	Principal	Interest ⁽¹⁾⁽³⁾	Principal	Interest
2015	172,305,000	109,576,370	6,790,000	35,898,252
2016	177,645,000	103,601,154	7,265,000	35,471,161
2017	211,265,000	96,014,279	7,770,000	35,014,193
2018	222,945,000	87,445,683	8,315,000	34,525,460
2019	192,640,000	77,258,561	8,895,000	34,002,446
2020	194,085,000	68,658,364	9,520,000	33,442,951
2021	160,495,000	59,531,508	20,145,000	32,844,143
2022	149,375,000	51,877,915	21,440,000	31,577,022
2023	161,465,000	44,750,851	22,805,000	30,228,446
2024	112,265,000	37,144,497	24,265,000	28,794,012
2025	116,580,000	31,893,950	25,820,000	27,267,743
2026	85,110,000	26,237,104	27,475,000	25,643,665
2027	105,940,000	22,111,784	29,235,000	23,915,488
2028	105,140,000	16,878,472	31,100,000	22,076,606
2029	73,830,000	11,962,041	41,425,000	20,120,416
2030	40,095,000	8,725,734	43,995,000	17,596,516
2031	20,310,000	6,866,358	58,135,000	14,915,274
2032	22,555,000	5,847,702	61,650,000	11,438,498
2033	14,985,000	4,736,712	22,965,000	7,750,357
2034	12,980,000	4,013,439	-	6,505,750
2035	14,945,000	3,372,958	44,345,000	6,505,750
2036	14,290,000	2,646,879	35,400,000	4,078,572
2037	11,585,000	1,954,478	22,425,000	2,122,367
2038	8,590,000	1,393,460	-	880,470
2039	6,045,000	982,846	-	880,470
2040	3,810,000	711,200	-	880,470
2041	3,990,000	532,800	20,250,000	880,470
2042	4,175,000	345,900	-	-
2043	3,005,000	150,250	-	-
	2,422,445,000	887,223,247	601,430,000	525,256,967

(1) Net of Build America Subsidies.

(2) Net of QECB Subsidy.

(3) U.S. Treasury subsidy receipts adjusted for 7.2% sequestration reduction.

FISCAL YEAR 2015 BUDGET

Tax Certificates		TOTAL		Total
Principal	Interest ⁽²⁾⁽³⁾	Principal	Interest	Debt Service
3,083,751	566,887	182,178,751	146,041,509	328,220,260
783,751	451,887	185,693,751	139,524,202	325,217,953
783,751	451,887	219,818,751	131,480,359	351,299,110
1,863,751	451,887	233,123,751	122,423,030	355,546,781
1,918,751	397,887	203,453,751	111,658,894	315,112,645
1,978,751	341,137	205,583,751	102,442,452	308,026,203
2,038,751	281,387	182,678,751	92,657,038	275,335,789
2,098,751	218,637	172,913,751	83,673,574	256,587,325
2,163,751	152,887	186,433,751	75,132,185	261,565,936
783,751	41,944	137,313,751	65,980,452	203,294,203
-	-	142,400,000	59,161,693	201,561,693
-	-	112,585,000	51,880,769	164,465,769
-	-	135,175,000	46,027,272	181,202,272
-	-	136,240,000	38,955,078	175,195,078
-	-	115,255,000	32,082,457	147,337,457
-	-	84,090,000	26,322,250	110,412,250
-	-	78,445,000	21,781,632	100,226,632
-	-	84,205,000	17,286,200	101,491,200
-	-	37,950,000	12,487,069	50,437,069
-	-	12,980,000	10,519,189	23,499,189
-	-	59,290,000	9,878,708	69,168,708
-	-	49,690,000	6,725,451	56,415,451
-	-	34,010,000	4,076,845	38,086,845
-	-	8,590,000	2,273,930	10,863,930
-	-	6,045,000	1,863,316	7,908,316
-	-	3,810,000	1,591,670	5,401,670
-	-	24,240,000	1,413,270	25,653,270
-	-	4,175,000	345,900	4,520,900
-	-	3,005,000	150,250	3,155,250
17,497,513	3,356,428	3,041,372,513	1,415,836,642	4,457,209,155