

2007-09-06-0948

AN ORDINANCE APPROVING THE UPDATE OF CERTAIN OFFERING DOCUMENTS RELATING TO OBLIGATIONS DESIGNATED AS CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A AND CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003; APPROVING AN AMENDMENT TO THE REVOLVING CREDIT AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A; APPROVING AN AMENDMENT TO THE STANDBY BOND PURCHASE AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003; APPROVING AN AMENDMENT TO THE STANDBY BOND PURCHASE AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2004; ENACTING OTHER PROVISIONS INCIDENT AND RELATED TO THE SUBJECT AND PURPOSE OF THIS ORDINANCE; AND PROVIDING AN EFFECTIVE DATE

WHEREAS, the City of San Antonio, Texas (the *City*) is a home rule municipality, a political subdivision of, and is duly organized and existing pursuant to the Constitution and laws of the State of Texas (the *State*);

WHEREAS, pursuant to State law, the City Council (the *Council*) of the City has heretofore issued, and there are currently outstanding, revenue obligations designated as "City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003" (the *Series 2003 Bonds*), "City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2004" (the *Series 2004 Bonds*), and "City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A" (the *Commercial Paper Notes*, and together with the Series 2003 Bonds herein referred to collectively as the *Outstanding Obligations*); and

WHEREAS, the ordinances authorizing the issuance of the Outstanding Obligations provide that the Outstanding Obligations bear interest at variable rates and the authorized representatives of the City Public Service Board of San Antonio, Texas (the *Board*), in consultation with its co-financial advisors and co-bond counsel, have made the determination to update the disclosure information contained in the offering documents previously approved by the Council in connection with the issuance of the Outstanding Obligations; and

WHEREAS, the authorized representatives of the Board have requested that the Council approve the updated offering documents; and

WHEREAS, the Council may authorize the updated offering documents pursuant to the ordinances authorizing the issuance of the Outstanding Obligations; and

WHEREAS, the Commercial Paper Notes bear interest at short term variable rates in accordance with current market conditions, and, in order to provide certain liquidity support for the Commercial Paper Notes, the City previously entered into a revolving credit agreement (the

Revolving Credit Agreement) with State Street Bank and Trust Company, as Administrative Agent, and State Street Bank and Trust Company and Bank of America, N.A., as Banks, in connection with the issuance of the Commercial Paper Notes; and

WHEREAS, the authorized representatives of the Board have provided written notice for an amendment to the Revolving Credit Agreement; and

WHEREAS, the Board has adopted a resolution requesting that the Council adopt an ordinance providing for the amendment of the Revolving Credit Agreement to increase the commitment amount and to extend the expiration date, among other matters; and

WHEREAS, the Council may authorize an amendment to the Revolving Credit Agreement pursuant to the ordinance authorizing the Commercial Paper Notes; and

WHEREAS, the Series 2003 Bonds bear interest at rates determined weekly in accordance with current market conditions, and, in order to provide certain liquidity support for the Series 2003 Bonds, the City previously entered into a standby bond purchase agreement (the *2003 Bonds Standby Bond Purchase Agreement*) with Bank of America, N.A., in connection with the issuance of the Series 2003 Bonds; and

WHEREAS, the authorized representatives of the Board have provided written notice for an extension to the 2003 Bonds Standby Bond Purchase Agreement; and

WHEREAS, the Board has adopted a resolution requesting that the Council adopt an ordinance providing for the amendment of the 2003 Bonds Standby Bond Purchase Agreement to extend the expiration date, among other matters; and

WHEREAS, the Council may authorize an amendment to the terms of the 2003 Bonds Standby Bond Purchase Agreement pursuant to the ordinance authorizing the Series 2003 Bonds (the *2003 Ordinance*); and

WHEREAS, the Series 2004 Bonds bear interest at a term rate in accordance with current market conditions, and, in order to provide certain liquidity support for the Series 2004 Bonds, the City previously entered into a standby bond purchase agreement (the *2004 Bonds Standby Bond Purchase Agreement*) with BNP Paribas in connection with the issuance of the Series 2004 Bonds; and

WHEREAS, the authorized representatives of the Board have provided written notice for an extension to the 2004 Bonds Standby Bond Purchase Agreement; and

WHEREAS, the Board has adopted a resolution requesting that the Council adopt an ordinance providing for the amendment of the 2004 Bonds Standby Bond Purchase Agreement to extend the expiration date, among other matters; and

WHEREAS, the Council may authorize an amendment to the terms of the 2004 Bonds Standby Bond Purchase Agreement pursuant to the ordinance authorizing the Series 2004 Bonds (the *2004 Ordinance*); and

WHEREAS, the Council hereby finds and determines the adoption of this ordinance is in the best interests of the citizens of the Council; NOW, THEREFORE,

BE IT ORDAINED BY THE CITY COUNCIL OF THE CITY OF SAN ANTONIO THAT:

SECTION 1. Authorization of Offering Documents for the Outstanding Obligations. The Council hereby approves the updated offering documents with respect to the Outstanding Obligations substantially in the form attached hereto as Exhibit A.

SECTION 2. Authorization of Amendment to the Revolving Credit Agreement for the Commercial Paper Notes. The Council hereby approves an amendment to the Revolving Credit Agreement, originally entered into with State Street Bank and Trust Company, as Administrative Agent, and State Street Bank and Trust Company and Bank of America, N.A., as Banks, for the Commercial Paper Notes, attached hereto as Exhibit A.

SECTION 3. Authorization of Amendment to the Standby Bond Purchase Agreement for the Series 2003 Bonds. The Council hereby approves an amendment to the Standby Bond Purchase Agreement, originally entered into with Bank of America, N.A. as the Liquidity Bank and U.S. Bank National Association (as the successor in interest to Wachovia Bank, National Association) as the Paying Agent/Registrar, for the Series 2003 Bonds, attached hereto as Exhibit A.

SECTION 4. Authorization of Amendment to the Standby Bond Purchase Agreement for the Series 2004 Bonds. The Council hereby approves an amendment to the Standby Bond Purchase Agreement, originally entered into with BNP Paribas as the Liquidity Bank and U.S. Bank National Association (as the successor in interest to Wachovia Bank, National Association) as the as the Paying Agent/Registrar, for the Series 2004 Bonds, attached hereto as Exhibit A.

SECTION 5. Inconsistent Provisions. All ordinances and resolutions, or parts thereof, which are in conflict or inconsistent with any provision of this Ordinance are hereby repealed to the extent of such conflict, and the provisions of this Ordinance shall be and remain controlling as to the matters resolved herein.

SECTION 6. Governing Law. This Ordinance shall be construed and enforced in accordance with the laws of the State of Texas and the United States of America.

SECTION 7. Severability. If any provision of this Ordinance or the application thereof to any person or circumstance shall be held to be invalid, the remainder of this Ordinance and the application of such provision to other persons and circumstances shall nevertheless be valid, and the Council hereby declares that this Ordinance would have been enacted without such invalid provision.

SECTION 8. Incorporation of Preamble Recitals. The recitals contained in the preamble hereof are hereby found to be true, and such recitals and other statements therein are hereby made a part of this Ordinance for all purposes and are adopted as a part of the judgment and findings of the Council.

SECTION 9. Public Meeting. It is officially found, determined, and declared that the meeting at which this Ordinance is adopted was open to the public and public notice of the time, place, and subject matter of the public business to be considered at such meeting, including this Ordinance, was given, all as required by Chapter 551, as amended, Texas Government Code.

SECTION 10. Further Proceedings. The officers and employees of the City are hereby authorized, empowered, and directed from time to time and at any time to do and perform all such acts and things and to execute, acknowledge, and deliver in the name and under the corporate seal and on behalf of the City all such instruments, whether or not herein mentioned, as may be necessary or desirable in order to carry out the terms and provisions of this Resolution. In case any officer of the City whose signature shall appear on any certificate shall cease to be such officer before the delivery of such certificate, such signature shall nevertheless be valid and sufficient for all purposes the same as if such officer had remained in office until such delivery.

SECTION 11. Effective Date. The effective date of this Ordinance shall be governed by the provisions of Section 1-15 of the City Code of San Antonio, Texas. This Ordinance shall take effect immediately if passed by the affirmative vote of at least eight members of the Council, otherwise the same shall take effect on the tenth day after the date of its passage by the Council.

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City Council Meeting

DATE: September 6, 2007

ORDINANCE: 2007-09-06-0948

AGENDA ITEM: 25

RESOLUTION:

NAME	ROLL CALL	MOTION	SECOND	ABSTAIN	AYE	NAY	ABSENT
Mary Alice Cisneros DISTRICT 1							
Sheila McNeil DISTRICT 2							
Roland Gutierrez DISTRICT 3							
Philip Cortez DISTRICT 4							
Lourdes Galvan DISTRICT 5							
Delicia Herrera DISTRICT 6							
Justin Rodriguez DISTRICT 7							
Diane Cibrian DISTRICT 8							
Kevin Wolff DISTRICT 9							
John Clamp DISTRICT 10							
Phil Hardberger MAYOR							

COMMENTS:

EXHIBIT A
OFFERING DOCUMENTS AND AMENDMENTS

City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A
Revolving Credit Agreement

\$225,000,000

San Antonio, Texas

September 6, 2007

For value received, the CITY OF SAN ANTONIO, TEXAS (the "City"), a home-rule city of the State of Texas, organized and existing under and by virtue of the laws of the State of Texas, promises to pay, solely from the funds hereafter referred to, to the order of BANK OF AMERICA, N.A. (the "Bank"), at the address provided, in the Agreement (hereinafter defined), the aggregate unpaid principal amount of all Loans hereunder and under the Agreement, not to exceed TWO HUNDRED TWENTY-FIVE MILLION DOLLARS (\$225,000,000) in principal amount at any one time outstanding, made by the Bank to the City hereunder, in lawful money of the United States of America, in federal or other immediately available funds, and to pay interest at the rates set forth in the Agreement on the actual unpaid principal amount hereof for each day outstanding from the date hereof until this Bank Note is paid in full, in like money and funds at such office. Interest shall be payable on the dates set forth in the Agreement. Principal on this Bank Note shall be payable in accordance with the Agreement.

This Bank Note is subject to prepayment, and amounts prepaid prior to the last day of the Revolving Credit Period may be reborrowed, all pursuant to the terms and under the conditions of the Revolving Credit Agreement, dated as of November 1, 2004, as amended, among the City, the Administrative Agent and the Bank (as amended, the "Agreement", the terms of which are hereby incorporated by reference in this Bank Note). All terms used herein and not defined shall have the same meaning as in the Agreement. Reference is made to the Agreement for provisions as to the prepayment hereof and for reborrowing. Reference is also made to the Agreement for provisions providing for additional interest and other amounts to be payable under certain circumstances. If the Holder enforces this Bank Note upon default, the City shall reimburse the Holder for reasonable costs and expenses incurred by the Holder in collection, including attorneys fees and expenses as set out in Section 8.04 of the Agreement. This Bank Note shall be construed under and governed by laws of the State of Texas but Chapter 346, Texas, Finance Code, as amended, shall not apply.

This Bank Note, including the interest hereon, is payable solely from and secured by a lien on and a pledge of the Net Revenues and certain other available funds and proceeds of the City, all as set forth in Section 2.09 of the Agreement and Section 2.12 of the Ordinance (as defined in the Agreement). This Bank Note does not constitute a general obligation or indebtedness of the City within the meaning of any constitutional, charter, or statutory limitations or provisions (and the Holder hereof shall never have the right to require or compel the levy of ad valorem taxes for the payment of the principal of and interest on this Bank Note). Further reference is made to the Agreement and the Ordinance for the provisions relating to the security of this Bank Note and the duties and obligations of the City.

This Bank Note represents an increase and replacement of that certain promissory note dated November 1, 2004 in the principal amount of \$175,000,000 executed by the City and payable to the order of the Bank.

Made and executed at San Antonio, Texas, as of the date and year first above written.

CITY OF SAN ANTONIO, TEXAS

By: 

Mayor

ATTEST:

By: 

City Clerk

(SEAL)



CERTIFICATE OF CITY CLERK

THE STATE OF TEXAS

§

COUNTY OF BEXAR

§

§

CITY OF SAN ANTONIO

§

§

THE UNDERSIGNED HEREBY CERTIFIES that:

1. On the 6th day of September, 2007, the City Council (the *Governing Body*) of the City of San Antonio, Texas (the *Issuer*) convened in regular session at its regular meeting place in the Municipal Plaza Building of the Issuer (the *Meeting*), the duly constituted members of the Governing Body being as follows:

Phil Hardberger	Mayor
Kevin Wolff	Mayor Pro Tem
Diane G. Cibrian	Councilmember
Lourdes Galvan	Councilmember
Mary Alice P. Cisneros	Councilmember
Sheila D. McNeil	Councilmember
Philip A. Cortez	Councilmember
Justin Rodriguez	Councilmember
Delicia Herrera	Councilmember
Roland Gutierrez	Councilmember
John G. Clamp	Councilmember

and all of such persons were present at the Meeting, except the following:
none, thus constituting a quorum. Among other business considered at the Meeting, the attached Ordinance (the *Ordinance*) entitled:

AN ORDINANCE APPROVING THE UPDATE OF CERTAIN OFFERING DOCUMENTS RELATING TO OBLIGATIONS DESIGNATED AS CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A AND CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003; APPROVING AN AMENDMENT TO THE REVOLVING CREDIT AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A; APPROVING AN AMENDMENT TO THE STANDBY BOND PURCHASE AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003; APPROVING AN AMENDMENT TO THE STANDBY BOND PURCHASE AGREEMENT RELATING TO THE CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2004; ENACTING OTHER PROVISIONS INCIDENT AND RELATED TO THE SUBJECT AND PURPOSE OF THIS ORDINANCE; AND PROVIDING AN EFFECTIVE DATE

was introduced and submitted to the Governing Body for passage and adoption. After presentation and due consideration of the Ordinance, a motion was made by Councilmember McNeil that the Ordinance be finally passed and adopted in accordance with the Issuer's Home Rule Charter. The motion was seconded by Councilmember Cisneros and carried by the following vote:

11 voted "For" 0 voted "Against" 0 abstained

all as shown in the official Minutes of the Governing Body for the Meeting.

2. The attached Ordinance is a true and correct copy of the original on file in the official records of the Issuer; the duly qualified and acting members of the Governing Body of the Issuer on the date of the Meeting are those persons shown above, and, according to the records of my office, each member of the Governing Body was given actual notice of the time, place, and purpose of the Meeting and had actual notice that the Ordinance would be considered; and the Meeting and deliberation of the aforesaid public business, including the subject of the Ordinance, was posted and given in advance thereof in compliance with the provisions of Chapter 551, as amended, Texas Government Code.

IN WITNESS WHEREOF, I have signed my name officially and affixed the seal of the Issuer, this 6th day of September, 2007.



Lucia M. Nieto
City Clerk, City of San Antonio, Texas

(SEAL)

FIRST AMENDMENT TO STANDBY BOND PURCHASE AGREEMENT

This FIRST AMENDMENT TO STANDBY BOND PURCHASE AGREEMENT having an effective date of October 1, 2007 (this "*Amendment*"), among the CITY OF SAN ANTONIO, TEXAS (the "*City*"), U.S. BANK NATIONAL ASSOCIATION (as successor to Wachovia Bank, National Association), as Paying Agent/Registrar (the "*Paying Agent/Registrar*"), and BNP PARIBAS, acting through its San Francisco Branch (the "*Liquidity Provider*"). All capitalized terms herein and not defined herein shall have the meanings set forth in the hereinafter defined Agreement.

WITNESSETH

WHEREAS, the City, the Paying Agent/Registrar and the Liquidity Provider have entered into that certain Standby Bond Purchase Agreement dated as of November 1, 2004 (the "*Agreement*"), relating to the City's Electric and Gas Systems Junior Lien Revenue Bonds, Series 2004 (the "*Bonds*");

WHEREAS, pursuant to Section 10.1 of the Agreement, the Agreement may be amended by a written amendment thereto, signed by the City and the Liquidity Provider;

WHEREAS, the parties hereto wish to amend the Agreement to, among other things, extend the scheduled Expiration Date of the Liquidity Provider's commitment and reduce the Commitment Fee payable in accordance with Section 2.7(a) of the Agreement;

NOW THEREFORE, in consideration of the premises, the parties hereto hereby agree as follows:

1. AMENDMENTS.

Upon satisfaction of the conditions precedent set forth in Section 2 hereof, the Agreement shall be amended as follows:

1.01. The definition of the term "*Expiration Date*" set forth in Section 1.1 of the Agreement is hereby amended in its entirety and as so amended shall be restated to read as follows:

"Expiration Date" means the later of (a) 5:00 p.m. New York time, on December 6, 2012 and (b) 5:00 p.m. New York time on the last day of any extension of such date pursuant to Section 10.9(b) hereof or, if such last day is not a Business Day, the Business Day next preceding such day.

1.02. Section 2.7(a) of the Agreement is hereby amended in its entirety and as so amended shall be restated to read as follows:

(a) The City hereby agrees to pay to the Liquidity Provider a nonrefundable commitment fee (the "*Commitment Fee*") at the rate of 0.075% per annum for the duration of the Commitment Period on the difference between the Available Commitment (as of the beginning of each period in respect of which payment is made) and the average amount outstanding advanced hereunder by the Liquidity Provider during each period in respect of which payment is made; provided, however, the Commitment Fee shall be increased by an additional 10 basis points (for a total Commitment of 0.175%) should any two of the three Rating Agencies lower the long-term debt rating of any Senior Lien Obligations to the "A" category (or its equivalent) and the Commitment Fee shall be increased by an additional 10 basis points (for a total Commitment Fee of 0.275%) should any two of the three Rating Agencies lower the long-term debt rating of any Senior Lien Obligations to the "BBB" category (or its equivalent). Such Commitment Fee shall be payable in immediately available funds quarterly in arrears (each such payment to be computed on the basis of a year of 365 or 366 days, as applicable, and the actual number of days elapsed) (i) on January 1, 2008, for the period from October 1, 2007 through December 31, 2007, and (ii) on the first Business Day of each April, July, October and January occurring thereafter during the Commitment Period, and on the last day of the Commitment Period. If the Available Commitment is terminated in its entirety, all accrued Commitment Fees shall be payable on the effective date of such termination.

2. CONDITIONS PRECEDENT.

The effectiveness of this Amendment is subject to the satisfaction of or waiver by the Liquidity Provider of all of the following conditions precedent:

2.01. Delivery by the City of an executed counterpart of this Amendment.

2.02. The following statements shall be true and correct as of the date hereof:

(a) the representations and warranties of the City contained in the Agreement and each of the Related Documents are true and correct on and as of the date hereof as though made on and as of such date (except to the extent the same expressly relate to an earlier date); and

(b) no Default or Event of Default has occurred and is continuing or would result from the execution of this Amendment.

2.03. Payment to the Liquidity Provider, on the effective date of this Amendment, of the legal fees of Chapman and Cutler LLP, legal counsel to the Liquidity Provider. The City and the

Liquidity Provider have mutually agreed on the actual payments to be made by the City to the Liquidity Provider concerning this Amendment.

2.04. All other legal matters pertaining to the execution and delivery of this Amendment shall be reasonably satisfactory to the Liquidity Provider and its counsel.

3. REPRESENTATIONS AND WARRANTIES THE CITY.

In addition to the representations given in Article V of the Agreement, the City hereby represents and warrants as follows:

3.01. The execution, delivery and performance by the City of this Amendment and the Agreement, as amended hereby, are within its powers, have been duly authorized by all necessary action and do not contravene any law or any contractual restriction binding on or affecting the City.

3.02. No authorization, approval or other action by, and no notice to or filing with, any governmental authority or regulatory body is required for the due execution, delivery and performance by the City of this Amendment or the Agreement, as amended hereby.

3.03. This Amendment and the Agreement, as amended hereby, constitute legal, valid and binding obligations of the City enforceable against the City in accordance with their respective terms, except that (i) the enforcement thereof may be limited by principles of sovereign immunity and by bankruptcy, reorganization, insolvency, liquidation, moratorium and other laws relating to or affecting the enforcement of creditors' rights and remedies generally, as the same may be applied in the event of the bankruptcy, reorganization, insolvency, liquidation or similar situation of the City, and (ii) no representation or warranty is expressed as to the availability of equitable remedies.

4. REPRESENTATIONS AND WARRANTIES THE LIQUIDITY PROVIDER.

The undersigned officers of the Liquidity Provider hereby represent and warrant as follows:

4.01. To the best knowledge of each of the undersigned officers of the Liquidity Provider and without any diligence with respect thereto, the execution, delivery and performance by the Liquidity Provider of this Amendment have been duly authorized by all necessary action or any contractual restriction binding on or affecting the Liquidity Provider.

4.02. To the best knowledge of each of the undersigned officers of the Liquidity Provider and without any diligence with respect thereto, this Amendment and the Agreement, as amended hereby, constitute legal, valid and binding obligations of the Liquidity Provider enforceable against the Liquidity Provider in accordance with their respective terms, except that (i) the enforcement thereof may be limited by bankruptcy, reorganization, insolvency, liquidation, moratorium and other laws relating to or affecting the enforcement of creditors' rights and

remedies generally, as the same may be applied in the event of the bankruptcy, reorganization, insolvency, liquidation or similar situation of the Liquidity Provider, and (ii) no representation or warranty is expressed as to the availability of equitable remedies.

5. MISCELLANEOUS.

Except as specifically amended herein, the Agreement shall continue in full force and effect in accordance with its terms. Reference to this Amendment need not be made in any note, document, agreement, letter, certificate, the Agreement or any communication issued or made subsequent to or with respect to the Agreement, it being hereby agreed that any reference to the Agreement shall be sufficient to refer to the Agreement, as hereby amended. In case any one or more of the provisions contained herein should be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired hereby. All capitalized terms used herein without definition shall have the same meanings herein as they have in the Agreement. THIS AMENDMENT, AND THE AGREEMENT, AS AMENDED HEREBY, SHALL BE DEEMED A CONTRACT UNDER, AND FOR ALL PURPOSES SHALL BE GOVERNED BY, AND CONSTRUED AND INTERPRETED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS.

This Amendment may be simultaneously executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument

Dated as of the date first above written.

CITY OF SAN ANTONIO, TEXAS

By: _____
Name: _____
Title: _____

BNP PARIBAS, acting through its San Francisco
Branch, as Liquidity Provider

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____

STATE STREET BANK AND TRUST COMPANY
One Lincoln Street
Boston, MA 02111-2900

BANK OF AMERICA, N.A.
300 Convent St., 5th Floor
San Antonio, TX 78205

September 6, 2007

City of San Antonio, Texas
c/o City Public Service Board of San Antonio, Texas
145 Navarro Street
San Antonio, Texas 78205

Re: Extension of Final Date, Increase of Commitment and Amendment of Revolving Credit Agreement for City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A

Ladies and Gentlemen:

Reference is made herein to that certain Revolving Credit Agreement dated as of November 1, 2004 (as amended from time to time, the "Agreement") by and among the City of San Antonio, Texas (the "City"), State Street Bank and Trust Company ("State Street"), as Administrative Agent and as a Bank, and Bank of America, N.A., as a Bank ("Bank of America" and together with State Street, the "Banks"). All capitalized terms used herein shall have the meanings ascribed to them in the Agreement.

The City, acting through the authorized representatives of CPS Energy, has requested that the Banks extend the Revolving Credit Period to November 1, 2012 pursuant to Section 2.10 of the Agreement and make certain amendments to the Agreement. Accordingly, subject to the terms of the Agreement and this letter and effective as of the date hereof, State Street and Bank of America hereby agree to the following:

(1) The Final Date, as defined in Section 1.01 of the Agreement, is hereby extended from November 1, 2010 to November 1, 2012;

(2) The Commitment, as defined in Section 1.01 of the Agreement, is hereby increased from \$350,000,000 to \$450,000,000 which increase shall be evidenced by the execution and delivery by the City of promissory notes payable to State Street and Bank of America, respectively, each in the principal amount of \$225,000,000; and

(3) The definition of "Commitment Fee" in Section 1.01 of the Agreement, is hereby replaced in its entirety with the following:

""Commitment Fee" shall mean the amount payable to the Administrative Agent, in its capacity as such, pursuant to Section 2.05 hereof and shall mean, as of any day when the S&P rating on the Senior Lien Obligations is as indicated below, the corresponding rate per annum indicated below:

<u>S&P Rating</u>	<u>Commitment Fee</u>
AA+	0.1025%
AA	0.1025

AA-	0.1075
A+	0.15
A	0.17
A-	0.19
BBB+	0.24
BBB	0.28
BBB-	0.33"

Except for the foregoing, all of the terms and provisions of the Agreement are hereby ratified and confirmed and shall continue in full force and effect.

The City hereby represents and warrants to State Street and Bank of America that (i) the execution, delivery and performance of this letter has been authorized by all requisite action on the part of the City and pursuant to the terms of the Agreement and will not violate any agreements to which the City is a party thereto, (ii) all of the representations and warranties contained in the Agreement are true and correct on and as of the date hereof as though made on and as of the date hereof, (iii) no Event of Default has occurred or is continuing and no event or condition has occurred that with the giving of notice or lapse of time or both would be an Event of Default, and (iv) the City is in full compliance with all covenants and agreements contained in the Agreement.

This letter may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument and any of the parties hereto may execute this letter by signing any such counterpart.

This letter embodies the entire agreement, as evidenced by the Agreement, and understanding between the parties and supersedes all prior agreements and understandings between such parties relating to the subject matter hereof. There are no unwritten oral agreements between the parties.

By its execution below, the City hereby agrees to the terms of this letter. State Street and Bank of America appreciate the opportunity to continue their successful relationship with the City.

Very truly yours,

Timothy Batler
Senior Vice President
State Street Bank and Trust Company

Rhonda Kolm Calvert
Senior Vice President
Bank of America, N.A.

Acknowledged and accepted by:

CITY OF SAN ANTONIO, TEXAS

By: _____
Richard E. Williamson
Treasurer

[LETTERHEAD OF BANK OF AMERICA, N.A.]

September 6, 2007

City Public Service Board of San Antonio, Texas
145 Navarro Street
San Antonio, Texas 78205

Re: Extension of Expiration Date and Amendment of Standby Bond Purchase Agreement for City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003

Ladies and Gentlemen:

Reference is made to that certain Standby Bond Purchase Agreement dated as of May 15, 2003 by and among U.S. Bank National Association (as successor to Wachovia Bank, National Association), as paying agent/registrar ("U.S. Bank"), Bank of America, N.A., and the City of San Antonio, Texas (the "City") as amended by those certain Letter Agreements dated as of April 15, 2004, August 27, 2004 and December 2, 2005, respectively (as amended, collectively, the "SBPA"). All capitalized terms used herein shall have the meanings ascribed to them in the SBPA.

We are in receipt of the City's Request for Extension of Expiration Date. Subject to the terms of this letter and effective as of October 1, 2007, we hereby agree to the following:

- (1) The Expiration Date is hereby extended to January 31, 2012; and
- (2) The Commitment Fee set forth in Section 2.7(a) of the SBPA is hereby increased to 0.085%.

Except for the foregoing, the terms and provisions of the SBPA are hereby ratified and confirmed and shall continue in full force and effect.

The City hereby represents and warrants to us that (i) the execution, delivery and performance of this letter has been authorized by all requisite action on the part of the City by the City Council of the City and will not violate any agreements to which the City is a party thereto, (ii) the representations and warranties contained in the SBPA are true and correct on and as of the date hereof as though made on and as of the date hereof, (iii) no Event of Default has occurred and is continuing and no event or condition has occurred that with the giving of notice or lapse of time or both would be an Event of Default, and (iv) the City is in full compliance with all covenants and agreements contained in the SBPA.

This letter may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument and any of the parties hereto may execute this letter by signing any such counterpart.

This letter embodies the entire agreement, as evidenced by the SBPA, and understanding between the parties and supersedes all prior agreements and understandings between such parties relating to the subject matter hereof. There are no unwritten oral agreements between the parties.

By its execution below, the City and U.S. Bank hereby agree to the terms of this letter. We are pleased with the opportunity to continue our relationship with the City.

Very truly yours,

Rhonda Kolm Calvert
Senior Vice President

Acknowledged and accepted by:

CITY OF SAN ANTONIO, TEXAS

By: _____
Richard E. Williamson
Treasurer

U.S. BANK NATIONAL ASSOCIATION

By: _____
Name: _____
Title: _____

UPDATED OFFICIAL STATEMENT

Dated: September 7, 2007

RATINGS:

See "RATINGS" herein

NOT A NEW ISSUE - Book-Entry-Only

Co-Bond Counsel delivered an opinion in connection with the original delivery of the Bonds to the effect that, subject to the matters described herein, interest on the Bonds under then existing statutes, regulations, rulings and court decisions (1) would be excludable from the gross income of the owners thereof for federal income tax purposes under section 103 of the Internal Revenue Code of 1986, as amended and (2) would not be included in computing the alternative minimum taxable income of individuals or, except as described herein, corporations. Co-Bond Counsel assumed continuing compliance by the City after the date of delivery with certain covenants contained in the Ordinance authorizing the issuance of the Bonds. Additionally, see "THE BONDS – Determination of Interest Rates: Rate Mode Changes" identifying circumstances when an opinion of nationally recognized bond counsel is required as a condition for an interest rate mode conversion. Co-Bond Counsel was not asked to undertake and did not undertake any review or investigation of and was not asked to express and did not express any opinion concerning the continuing treatment of the interest on the Bonds as excludable from gross income for federal income tax purposes. See "TAX MATTERS" herein.



\$250,000,000
CITY OF SAN ANTONIO, TEXAS
ELECTRIC AND GAS SYSTEMS JUNIOR LIEN
REVENUE BONDS, SERIES 2003
(CUSIP: 796253VH2)*

Issued: May 15, 2003

Due: February 1, 2033

- Interest:** The Bonds were issued initially and remain in a Weekly Mode. While the Bonds are in a Weekly Mode (i) they will bear interest for one-week periods beginning each Wednesday at the Weekly Rate to be determined by the Remarketing Agent on the preceding business day and (ii) interest on the Bonds will be payable on the first Business Day of each month, initially on June 1, 2003. See "THE BONDS – INTEREST".
- Put Option; Redemption:** While the Bonds are in a Weekly Mode, they (i) must be purchased on demand of the owners, given seven days in advance, on any Business Day at a price equal to 100% of principal amount plus accrued interest and (ii) will be subject to optional or mandatory redemption and to mandatory tender for purchase on any Business Day as described herein. See "THE BONDS – PURCHASE OF BONDS" and "THE BONDS – REDEMPTION OF BONDS".
- Liquidity:** Any Bonds tendered for purchase and not remarketed will be purchased by Bank of America, N.A. under a Standby Bond Purchase Agreement, as amended ("Liquidity Facility"), or by the obligor under any substitute Liquidity Facility, unless the facility is sooner terminated as described herein. *The City is not obligated to pay the purchase price of tendered Bonds. The Standby Bond Purchase Agreement may be terminated without prior notice under certain conditions.* See "STANDBY BOND PURCHASE AGREEMENT".
- Purpose:** The Bonds were issued to provide funds for the purposes of acquiring, purchasing, constructing, improving, renovating, enlarging, and equipping the City's electric and gas utilities systems and paying the costs of issuance of the Bonds.
- Security:** The Bonds are limited obligations of the City. Principal and interest are payable solely from, and are equally and ratably secured, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City, by a junior and inferior lien on and pledge of the Net Revenues of the Systems remaining after payment of certain currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City. The purchase price of Bonds tendered for purchase is payable solely from proceeds of the remarketing of such Bonds by the Remarketing Agent or, if insufficient, payments made under the Liquidity Facility. See "THE BONDS – BOND PROVISIONS – Sources of and Security for Payment".
- Denominations:** While the Bonds are in the Weekly Mode, they are issuable in denominations of \$100,000 and multiples of \$5,000 in excess thereof. See "THE BONDS – GENERAL".
- Conversion:** The interest rate mode for the Bonds may be converted, in whole or part, from the Weekly Mode to one or more different interest rate modes at the option of the City. Thereafter the interest rates, interest rate periods, interest payment dates, and provisions for redemption and mandatory tender of the Bonds, as well as the rights of owners to have their Bonds purchased, may change. See "THE BONDS – INTEREST – Conversion of Interest Modes".

PRICE: 100%

The Bonds were originally offered when, as and if issued, subject to prior sale and to opinions of the Attorney General of the State of Texas and Fulbright & Jaworski L.L.P., San Antonio, Texas and Escamilla & Poneck, Inc., San Antonio, Texas, Co-Bond Counsel. Certain matters were passed upon for the City by the City Attorney and by Cox Smith Matthews, San Antonio, Texas, General Counsel to the City Public Service Board, and for the Remarketing Agent by Andrews Kurth, LLP, Houston, Texas. The Bonds were available for initial delivery to the Remarketing Agent and credit through DTC on May 15, 2003.

LEHMAN BROTHERS

* A CUSIP number has been assigned to this issue by an organization not affiliated with the City and is included for the convenience of the Bondholders only. The City shall not be responsible for the selection of CUSIP numbers, nor is any representation made as to their correctness on the Bonds or as indicated herein.

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WEEKLY MODE SUMMARY

The Bonds were issued initially in the Weekly Mode, during which the Bonds will (i) bear interest at Weekly Rates determined by the Remarketing Agent and (ii) be purchased on demand of the beneficial owners as described herein. The mode for the Bonds or portions thereof may be changed at the direction of the City on conditions described herein. See "THE BONDS – INTEREST – Conversion of Interest Modes" herein.

INTEREST RATE: Weekly Rates will be effective from the date of initial delivery of the Bonds and, thereafter, from Wednesday in each week through the following Tuesday. The Weekly Rate will be determined by the Remarketing Agent on each Tuesday (or, if not a business day for the Remarketing Agent, on the next day or, if also not a business day, then on the business day before Tuesday). Each Weekly Rate will be the lesser of 10% per annum (unless the Liquidity Facility then in effect under the Ordinance covers a lower rate of interest) or the Market Rate, which is the minimum per annum interest rate for the relevant interest rate period that, in the judgment of the Remarketing Agent, is necessary to produce a bid for the Bonds in the Weekly Mode on the rate determination date equal to 100% of principal amount plus accrued interest, if any. The determination of Weekly Rates by the Remarketing Agent will be conclusive and binding on the owners of the Bonds.

INTEREST PAYMENT DATES: Interest on the Bonds accrued at a Weekly Rate is payable on the first Business Day of each month, initially on June 1, 2003, and on the Business Day immediately succeeding the last day of the Weekly Mode. The record date for such interest is the immediately preceding day. On each interest payment date, interest is paid through the preceding day.

TENDER PURCHASE OPTION: The Bonds or portions thereof in a Weekly Mode must be purchased by the Paying Agent/Registrar on demand by the beneficial owners from sources of funds described below at a price equal to 100% of principal amount plus accrued interest, if any, upon seven days irrevocable written notice as described herein. See "THE BONDS – PURCHASE OF BONDS – Optional Tender – Weekly Mode" herein.

SOURCES OF PAYMENT: The Bonds are limited obligations of the City payable solely from and secured, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City, by a junior and inferior lien on and pledge of the Net Revenues of the Systems remaining after payment of certain currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City.

The purchase price of the Bonds tendered for purchase will be payable solely from proceeds of remarketing the Bonds or, to the extent such proceeds are insufficient, payments made by Bank of America, N.A. or any successor Liquidity Bank under the Liquidity Facility described herein, or, if such funds are insufficient, from payments, if any, elected to be made by the City in its sole discretion. Under certain circumstances, the Liquidity Facility may be suspended or terminated without prior notice. See "STANDBY BOND PURCHASE AGREEMENT – Termination or Suspension of Commitment" herein.

Principal and interest on the Bonds are payable solely from, and are equally and ratably secured, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City, by a junior lien on and pledge of the Net Revenues of the Systems remaining after payment of certain currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City.

MANDATORY TENDER; REDEMPTION: If the mode for the Bonds is changed, and in the event of changes to liquidity support described below, the affected Bonds or portions thereof must be tendered to and purchased by the Paying Agent/Registrar, at a price equal to 100% of principal amount plus accrued interest, if any, payable from the sources of funds described above. See "THE BONDS – PURCHASE OF BONDS – Mandatory Tender" herein. While in the Weekly Mode, the Bonds may be redeemed by the City on any Business Day at a redemption price equal to 100% of principal amount plus accrued interest, if any.

LIQUIDITY FACILITY SUBSTITUTION: If the Liquidity Facility is replaced or otherwise released, or if the Liquidity Facility expires or is terminated on prior notice to the Paying Agent/Registrar, the Bonds must first be tendered to and purchased by the Paying Agent/Registrar from the sources of funds described above.

NOTICES: The Paying Agent/Registrar must give DTC at least 20 days notice of mandatory tender and redemptions, changes in interest rate ceilings, substitutions and extensions of the Liquidity Facility, and addition of any Credit Facility for the Bonds. Beneficial owners may receive a copy of notices and other information directly by registering with the Paying Agent/Registrar. See "CONTINUING DISCLOSURE OF INFORMATION" herein.

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CONTACT INFORMATION

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CITY OF SAN ANTONIO, TEXAS

CITY COUNCIL

Phil Hardberger, Mayor

Diane Cibrian
Mary Alice P. Cisneros
John G. Clamp

Philip A. Cortez
Lourdes Galvan
Roland Gutierrez
Delicia Herrera

Sheila D. McNeil
Justin Rodriguez
Kevin Wolff

Sheryl Sculley - City Manager
Ben Gorzell, Jr. - Director of Finance
Leticia M. Vacek - City Clerk
Michael D. Bernard - City Attorney

CITY PUBLIC SERVICE BOARD OF SAN ANTONIO

Stephen S. Hennigan, Chairman
Alvaro Sanchez, Jr., Trustee

Clayton T. Gay Jr., Trustee

Aurora Geis, Vice Chairman
Phil Hardberger, Mayor

Milton B. Lee - General Manager and CEO
Richard E. Williamson – Treasurer, Executive Vice President and Chief Financial Officer
Carolyn E. Shellman, Esq. – General Counsel

CONSULTANTS

Fulbright & Jaworski L.L.P. and
Escamilla & Poneck, Inc.
Co-Bond Counsel

First Southwest Company and
Estrada Hinojosa & Company, Inc.
Co-Financial Advisors

No dealer, broker, salesman, or other person has been authorized by the City to give any information or to make any representation with respect to the Bonds, other than as contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the City. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation, or sale. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made shall under any circumstances create any implication that there has been no change in the information or opinions set forth herein after the date of this Official Statement. See "CONTINUING DISCLOSURE OF INFORMATION" for a description of the undertaking of the City and the Board to provide certain information on a continuing basis.

THE BONDS ARE EXEMPT FROM REGISTRATION WITH THE SECURITIES AND EXCHANGE COMMISSION AND CONSEQUENTLY HAVE NOT BEEN REGISTERED THEREWITH. THE REGISTRATION, QUALIFICATION, OR EXEMPTION OF THE BONDS IN ACCORDANCE WITH APPLICABLE SECURITIES LAW PROVISIONS OF THE JURISDICTIONS IN WHICH THESE SECURITIES HAVE BEEN REGISTERED, QUALIFIED, OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION FOR THE PURCHASE THEREOF.

IN CONNECTION WITH THIS OFFERING, THE REMARKETING AGENT MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The Remarketing Agent has provided the following sentence for inclusion in this Official Statement. The Remarketing Agent has reviewed the information in this Official Statement in accordance with, and as part of their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Remarketing Agent does not guarantee the accuracy or completeness of such information.

The Co-Financial Advisors have provided the following sentence for inclusion in this Official Statement. The Co-Financial Advisors have reviewed the information in this Official Statement in accordance with, and as part of their responsibilities to the City and as applicable to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Co-Financial Advisors do not guarantee the accuracy or completeness of such information.

Neither the City, the Co-Financial Advisors, nor the Remarketing Agent make any representation or warranty with respect to the information contained in this Official Statement regarding The Depository Trust Company or its Book-Entry-Only System.

The agreements of the City and others related to the Bonds are contained solely in the contracts described herein. Neither this Official Statement nor any other statement made in connection with the offer or sale of the Bonds is to be construed as constituting an agreement with the purchasers of the Bonds.

THE COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY AND IS NOT INTENDED AS A SUMMARY OF THIS OFFERING. INVESTORS SHOULD READ THE ENTIRE OFFICIAL STATEMENT, INCLUDING ALL APPENDICES ATTACHED HERETO, TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.

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The cover page, subsequent pages hereof, and Appendices attached hereto, are part of this Official Statement.

UPDATED OFFICIAL STATEMENT

Relating To

\$250,000,000

CITY OF SAN ANTONIO, TEXAS

ELECTRIC AND GAS SYSTEMS JUNIOR LIEN

REVENUE BONDS, SERIES 2003

INTRODUCTORY STATEMENT

This Updated Official Statement ("Official Statement"), including the cover page and the Appendices, of the City of San Antonio, Texas ("City"), provides information regarding the remarketing (upon tender for purchase from time to time) of its Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003 originally issued on May 15, 2003 in the aggregate principal amount of \$250,000,000 ("Bonds"). The Bonds were issued pursuant to an ordinance adopted by the City Council of the City ("City Council") on May 1, 2003 ("Ordinance"). Certain demographic and other information regarding the City are set forth in APPENDIX A. Certain capitalized terms used in this Official Statement have the meanings described in APPENDIX C.

The City owns and operates the electric and gas utility systems ("Systems"). Under the Ordinance, management and control of the Systems is completely vested in the City Public Service Board ("Board" or "CPS") of the City, except for certain retained rights of the City Council to approve replacement trustees nominated by the Board, to issue debt, to adjust rates, and to review Board actions concerning research, development and planning.

The Bonds are limited obligations of the City. Principal of and interest on the Bonds are payable solely from and to the extent of and are secured, together with the currently outstanding Junior Lien Obligations, by a junior lien on and pledge of, the Net Revenues of the Systems remaining after monthly payments or transfers to provide for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations outstanding from time to time, but prior to the payment of the currently outstanding Commercial Paper Obligations. The City has previously issued and there remain outstanding as of September 7, 2007, \$3,108,510,000 aggregate principal amount of Senior Lien Obligations. The City has reserved the right to issue Additional Senior Lien Obligations, as well as Additional Junior Lien Obligations secured on parity with the Bonds and the currently outstanding Junior Lien Obligations, from time to time in accordance with the provisions of the Ordinance described herein. The City may also issue obligations secured by inferior liens on Net Revenues of the Systems without limitation, including \$450,000,000 currently authorized commercial paper notes ("Notes"), of which \$350,000,000 was outstanding as of September 7, 2007.

The Bonds were initially issued and remain in a Weekly Mode. While in a Weekly Mode, the Bonds will bear interest for one-week periods beginning each Wednesday at the Weekly Rate to be determined by the Remarketing Agent on the preceding business day, and interest on the Bonds will be payable on the first Business Day of each month, beginning June 1, 2003. While the Bonds are in a Weekly Mode, they must be purchased on demand of the owners, pursuant to notice given seven days in advance, on any Business Day at a price equal to 100% of principal amount plus accrued interest, and will be subject to optional or mandatory redemption and to mandatory tender for purchase on any Business Day as described herein. The interest rate mode for the Bonds may be converted, in whole or in part, from the Weekly Mode to one or more different interest rate modes at the option of the City. Thereafter the interest rates, interest rate periods, interest payment dates, and provisions for redemption and mandatory tender of the Bonds, as well as the rights of owners to have their Bonds purchased, may change.

The purchase price of the Bonds tendered for purchase is payable solely from and to the extent of (1) proceeds of the remarketing of such Bonds by Lehman Brothers Inc. or any substitute Remarketing Agent or, if insufficient, (2) payments made under a standby bond purchase agreement, as amended ("Standby Bond Purchase Agreement") with Bank of America, N.A. ("Bank") or any substitute liquidity facility provided to and accepted by the Paying Agent/Registrar in accordance with the Ordinance as described herein or, if insufficient, (3) payments, if any, elected to be made by the City in its sole discretion. The Standby Bond Purchase Agreement and any such substitute liquidity facility are referred to herein as the "Liquidity Facility". The Bank and the obligors on any substitute Liquidity Facility are referred to herein as the "Liquidity Bank". Under certain circumstances described herein, the Liquidity Facility may be terminated without prior notice, following which no person will be obligated to purchase tendered Bonds.

There follows in this Official Statement a description of the City, CPS, and the Systems; certain information relating to the City and the State of Texas ("State"); certain information relating to the sources of payment for the Bonds, together with summaries of certain provisions of the Ordinance and the Bonds; and, a discussion of factors affecting the electric and gas

industries generally. All references herein to agreements and documents are qualified in their entirety by reference to the definitive forms thereof, and all references to the Bonds are further qualified by reference to the information with respect thereto contained in the Ordinance. Copies of such documents may be obtained from the City or First Southwest Company and Estrada Hinojosa & Company, Inc. ("Co-Financial Advisors") by electronic mail or upon payment of reasonable copying, handling, and delivery charges.

This Official Statement speaks only as to its date, and the information contained herein is subject to change. A copy of the Official Statement will be deposited with the Municipal Securities Rulemaking Board ("MSRB"), 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. See "CONTINUING DISCLOSURE OF INFORMATION" for a description of the City's and the Board's undertaking to provide certain information on a continuing basis.

THE INFORMATION AND EXPRESSIONS OF OPINION IN THIS OFFICIAL STATEMENT ARE SUBJECT TO CHANGE WITHOUT NOTICE AFTER SEPTEMBER 7, 2007, AND FUTURE USE OF THIS OFFICIAL STATEMENT SHALL NOT OTHERWISE CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE SINCE SEPTEMBER 7, 2007 IN THE MATTERS REFERRED TO IN THIS OFFICIAL STATEMENT.

THE BONDS

The following is a summary of certain provisions of the Bonds, which are summarized further in the table entitled "SUMMARY OF SHORT-TERM MODES" herein.

GENERAL

The Bonds are outstanding in the aggregate principal amount of \$250,000,000, will mature on February 1, 2033, are subject to mandatory and optional redemption, and will bear interest from the date of their initial delivery or the most recent interest payment date therefor to which interest has been paid or duly provided at rates per annum determined as described herein. The Bonds were initially issued and remain in the Weekly Mode, during which they will bear interest at a Weekly Rate determined by the Remarketing Agent, but the mode of all or any part of the Bonds may be converted to a Daily Mode, Commercial Paper Mode, Auction Mode, Term Mode, or Fixed Mode. See "THE BONDS – INTEREST".

The Bonds are issuable in fully registered form only, without coupons, in denominations of \$100,000 and integral multiples of \$5,000 in excess thereof, if issued in any mode other than the Auction Mode, Term Mode, or Fixed Mode, in denominations of \$50,000 and any integral multiple thereof if issued in an Auction Mode, and in denominations of \$5,000 and any integral multiple thereof if issued in the Term Mode or Fixed Mode.

The principal of and interest on the Bonds will be paid to Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"), while it acts as securities depository for the Bonds. See "THE BONDS – BOND PROVISIONS – Book-Entry-Only System" below. If DTC resigns as or is removed from serving as securities depository for the Bonds and is not replaced, principal and interest will be payable to the registered owners as of the applicable record date. U.S. Bank National Association, as the successor in interest to Wachovia Bank, National Association (together with successors, the "Paying Agent" or "Paying Agent/Registrar") will act as the paying agent and registrar for the City with respect to the Bonds.

The beneficial owners of the Bonds in a Weekly Mode or Daily Mode will have the right to have their interests in such Bonds purchased in (and leaving) authorized denominations, on demand with the notice described herein, and interests in the Bonds in all modes other than the Fixed Mode must be tendered for purchase, at a price equal to 100% of principal amount plus accrued interest, on the dates and conditions and with the notice, if any, described below under "THE BONDS – PURCHASE OF BONDS". The purchase price of any Bonds required to be purchased will be payable solely from and to the extent of (1) proceeds of the remarketing of such Bonds by the Remarketing Agent or, to the extent such proceeds are insufficient, (2) amounts advanced by the Bank under the Standby Bond Purchase Agreement or by the obligor on any substitute Liquidity Facility or, if such funds are insufficient, (3) payments, if any, elected to be made by the City in its sole discretion. *The City is not obligated to pay the purchase price of tendered Bonds. The Standby Bond Purchase Agreement may be terminated without prior notice under certain conditions.* See "STANDBY BOND PURCHASE AGREEMENT – Termination or Suspension of Commitment" herein.

The City has reserved the right, but is not obligated, to provide a letter of credit, policy of insurance, surety bond, acceptance, or guarantee to the Paying Agent/Registrar to support payment of the principal of and interest on the Bonds on at least 20 days notice to the registered owners of the Bonds. Any such obligation delivered to the Paying Agent/Registrar is referred to herein as the "Credit Facility", and the obligor on any such obligation is referred to herein as the "Credit Enhancer".

Lehman Brothers Inc. has been appointed initial Remarketing Agent for the Bonds. The Remarketing Agent may resign or be removed by the City. The City is then required to appoint a substitute remarketing agent unless the mode for all the Bonds has been converted to an Auction Mode or Fixed Mode. See "REMARKETING AGREEMENT" herein.

References to the Bonds herein include reference to any portion of a Bond in the applicable mode and interest rate period or to be redeemed or purchased. References to "Business Day" for the Bonds refer to a day other than (1) a Saturday or Sunday, (2) a day on which the New York Stock Exchange is closed, or (3) a legal holiday or the equivalent on which banking institutions generally are authorized or required to close in the city where principal of or interest on the Bonds is payable or in which the principal corporate trust office of the Paying Agent/Registrar or (unless such Bonds are in a Fixed Mode) the principal office of the Remarketing Agent or the applicable office of the Liquidity Bank, the Credit Enhancer, if any, or its agent for payment are located.

INTEREST

General

The Bonds were initially issued and remain in the Weekly Mode, during which they bear interest at the Weekly Rate described below under "Weekly Mode".

The mode for the Bonds or any portion thereof may be converted to a different mode, or to an Auction Mode or Term Mode with an interest rate period of different duration, at the direction of the City as described below under "Conversion of Interest Modes". Following such a conversion, such Bonds or portion thereof will bear interest at the corresponding Daily Rate, Weekly Rate, Auction Rate, Commercial Paper Rate, Term Rate, or Fixed Rate described below. Any such conversion (1) will be subject to receipt of an opinion of nationally recognized bond counsel (unless such conversion is between any two of a Daily Mode, Weekly Mode, Commercial Paper Mode, or Term Mode with interest rate periods of one year) to the effect that such conversion will not adversely affect any exclusion of interest on any Bond from gross income for federal income tax purposes and is authorized by applicable Texas law and (2) will result in the mandatory tender of affected Bonds or portions thereof for purchase as described below under THE BONDS – PURCHASE OF BONDS – Mandatory Tender".

When the Bonds bear interest at a Daily Rate, Weekly Rate, Commercial Paper Rate, or Bank Rate, interest on such Bonds will be computed on the basis of a 365- or 366-day year, as applicable, for actual days elapsed. When the Bonds bear interest at an Auction Rate for interest rate periods of six months or less, interest on such Bonds will be computed on the basis of a 360-day year for actual days elapsed. When the Bonds bear interest at an Auction Rate for longer interest rate periods or at a Term Rate or Fixed Rate, interest on such Bonds will be computed on the basis of a 360-day year comprised of twelve 30-day months. Interest accruing on the Bonds in each mode will be payable on the dates described below and on the Business Day following the conversion to a different mode. Interest due on each interest payment date will include interest accrued through the preceding day.

Daily Mode

On each day during which Bonds are in a Daily Mode, they will bear interest at the Daily Rate for the Bonds of such series and such day. The Daily Rate for the Bonds is a per annum rate of interest equal to the Market Rate determined by the Remarketing Agent by 10:00 a.m., New York, New York, time, on the applicable day (or, if such day is not a business day for the Remarketing Agent, on the immediately preceding business day), but not more than the Maximum Rate. See below "Market Rate Determination; Maximum Rate" herein.

Interest accrued on Bonds in a Daily Mode will be payable on the first Business Day of each month, and the record date for such interest payment will be the immediately preceding day.

While in a Daily Mode, Bonds may be tendered to the Paying Agent/Registrar for purchase on the same Business Day upon the notice described below under "THE BONDS – PURCHASE OF BONDS – Optional Tender" and they may be redeemed or repurchased on any Business Day on not less than 20 days notice as described under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender" and "THE BONDS – REDEMPTION OF BONDS" herein.

Weekly Mode

When Bonds are in a Weekly Mode, they will bear interest at the Weekly Rate, which is a Market Rate determined by the Remarketing Agent for each one-week period, beginning on Wednesday of each week and ending on the Tuesday of the

following week, but not more than the Maximum Rate. The Remarketing Agent is required to determine such rate by 4:00 p.m., New York, New York, time, on its last business day before the commencement of such Weekly Mode and on the day before each succeeding Wednesday thereafter (or, if not a business day for the Remarketing Agent, then on such Wednesday, or, if neither is a business day for the Remarketing Agent, then its last business day before such Wednesday, or on such other day as may be specified by such Remarketing Agent after notice to the City and the Bondholders). See "Market Rate Determination; Maximum Rate" herein.

Interest accrued on Bonds while they are in a Weekly Mode will be payable on the first Business Day of each month, beginning in June 2003, and the record date for such interest payment will be the immediately preceding day.

While in a Weekly Mode, the Bonds may be tendered to the Paying Agent/Registrar for purchase on any Business Day upon seven days written notice as described below under "THE BONDS – PURCHASE OF BONDS – Optional Tender in Weekly Mode", and they may be redeemed or purchased on any Business Day upon not less than 20 days notice as described under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender" and "THE BONDS – REDEMPTION OF BONDS" herein.

Commercial Paper Mode

During each interest rate period for Bonds in a Commercial Paper Mode, they will bear interest at the Commercial Paper Rate for such interest rate period. The Commercial Paper Rate for an interest rate period in a Commercial Paper Mode is the Market Rate for such interest rate period determined by the Remarketing Agent by 12:30 p.m., New York, New York, time, on or before its first Business Day in the interest rate period, but not more than the Maximum Rate. The duration of each interest rate period in a Commercial Paper Mode may be from one to 270 calendar days and will be determined by the Remarketing Agent as described below under "Determination of Interest Rate Periods".

Interest accrued on Bonds during each interest rate period while they are in a Commercial Paper Mode will be payable on the first Business Day following such interest rate period, and the record date for such interest payment will be the immediately preceding day.

While Bonds are in a Commercial Paper Mode, they may not be tendered to the Paying Agent/Registrar for purchase at the option of the owner. Bonds in a Commercial Paper Mode will, however, be required to be tendered for purchase on the Business Day following each interest rate period therefor without further notice and otherwise as described below under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender". Bonds in a Commercial Paper Mode may only be redeemed on such a mandatory purchase date.

Auction Mode

During the initial interest rate period for Bonds in an Auction Mode, they will bear interest at the Market Rate determined by the Remarketing Agent on the preceding Business Day. During each ensuing interest rate period for Bonds in an Auction Mode, they will bear interest at the clearing rate bid at an auction for such Bonds conducted immediately prior to the rate period as described in the Ordinance. The resulting auction rates may not be less than 45% of reference rates for specified taxable high-grade securities of comparable term described in the Ordinance. If an auction is not held immediately prior to an interest rate period, such Bonds will bear interest at 300% of such reference rates, if a default in payment of the Bonds and under any Credit Facility exists, and otherwise 75-100% of such reference rates, depending on the credit ratings then assigned to the Bonds. If the conditions to an elected change in interest rate period for the Bonds in an Auction Mode are not satisfied, they will bear interest at a rate equal to 75-100% of such reference rates, depending on the credit rating then assigned to the Bonds. In no event, however, may the Bonds bear interest at a rate greater than 15% per annum in an Auction Mode, including the portion of interest payable to the Auction Agent as a service charge.

The duration of interest rate periods in an Auction Mode may be fixed by the City as daily periods, weekly periods, four-week periods, five-week periods, three-month periods, six-month periods or longer periods. The duration may be changed at the election of the City as described below under "Determination of Interest Rate Periods".

Interest accrued on Bonds in each interest rate period in an Auction Mode will be payable (i) if a daily rate period, on the next first Business Day of a month following the interest rate period, (ii) if a weekly, four-week, five-week, three-month, or six-month interest rate period, on the first Business Day after the interest rate period, and (iii) if a longer interest rate period, the first Business Day after each thirteenth Tuesday in the period and the first Business Day after the period. The record date for such interest will be the second preceding Business Day.

While in an Auction Mode, the Bonds may be required to be tendered for purchase pursuant to auction procedures provided in the Ordinance and as described below under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender", but are not subject to purchase on demand of the owner.

Term Mode

During each interest rate period during which Bonds are in a Term Mode, they will bear interest at the Term Rate for such interest rate period. The Term Rate for an interest rate period in a Term Mode is the Market Rate for such interest rate period determined by the Remarketing Agent on any day designated by it which is not more than 35 days preceding nor later than its last business day preceding such interest rate period, but not more than the Maximum Rate. See "THE BONDS – INTEREST – Market Rate Determination; Maximum Rate" below. The duration of the interest rate periods in each Term Mode must be one year or more and will be determined by the City as described below under "Determination of Interest Rate Periods".

Interest accrued on Bonds during any interest rate period while they are in a Term Mode will be payable semiannually on each February 1 and August 1, and the record date therefor will be the 15th calendar day of the preceding calendar month or the first day of such Term Mode, whichever is later.

While Bonds are in a Term Mode, they may not be tendered to the Paying Agent/Registrar for purchase at the option of the owner. They will, however, be required to be tendered for purchase on the Business Day after each interest rate period as described below under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender". They will also be subject to mandatory sinking fund and optional redemption on such Business Days as described herein and to mandatory tender for purchase at other times upon certain events at the option of the Liquidity Bank. See "THE BONDS – REDEMPTION OF BONDS"; and "THE BONDS – PURCHASE OF BONDS – Mandatory Tender – Mode Changes".

Fixed Mode

When Bonds are in a Fixed Mode, they will bear interest at the Fixed Rate for such Bonds. The Fixed Rate for Bonds is the Market Rate for such Bonds determined by the Remarketing Agent on any day designated by it which is not more than 35 days preceding nor later than its last business day preceding the Fixed Mode for such Bonds. The Fixed Mode for Bonds, once commenced, will extend to the final maturity of such Bonds and will comprise a single interest rate period.

Interest accrued on Bonds in a Fixed Mode will be payable semiannually on each February 1 and August 1, and the record date for such interest will be the 15th calendar day of the preceding calendar month or the first day of such Fixed Mode, whichever is later.

While in a Fixed Mode, Bonds may not be tendered for purchase at the option of the owner. They will, however, be subject to mandatory sinking fund redemption and optional redemption at the times and price and in the amounts described herein under "THE BONDS – REDEMPTION OF BONDS".

Bank Bonds

Tendered Bonds purchased through the Liquidity Facility and not remarketed ("Bank Bonds") will bear interest at the Bank Rate, rather than the Daily Rate, Weekly Rate, Commercial Paper Rate, Auction Rate, Term Rate, or Fixed Rate from time to time in effect, but the excess of interest accrued at the Bank Rate over interest that would have accrued at such other rate ("Bank Differential") will be payable to the Liquidity Bank or its assignees rather than to the registered owner of the Bond as of the record date for such interest. Accordingly, payments of interest made through Cede & Co. on interest payment dates or redemption dates, and payments of the purchase price due on the tender of the Bonds for purchase or in determining the Market Rate, will exclude Bank Differential, whether or not expressly stated elsewhere herein. Bank Bonds may be redeemed in whole or in part on any day and are not subject to optional or mandatory tender for purchase.

Market Rate Determination; Maximum Rate

The Remarketing Agent is required to make each determination of the "Market Rate" for such Bonds by determining, under prevailing market conditions, the minimum interest rate necessary, in the judgment of the Remarketing Agent, to be borne

by such Bonds for the relevant interest rate period to produce a bid for such Bonds equal to 100% of the principal amount thereof plus accrued interest, if any.

If for any reason no Remarketing Agent has been appointed under the Ordinance on any rate determination date, the Remarketing Agent fails to determine a Market Rate on such rate determination date, or any Market Rate determined by the Remarketing Agent on such rate determination date is determined by a court of competent jurisdiction to be invalid or unenforceable, the Market Rate to be determined by the Remarketing Agent on such rate determination date will be determined as follows: If the interest rate period during which such Market Rate is to be in effect is greater than one-half year, the Market Rate for such interest rate period will be the percentage of the 11-Bond Municipal Bond Index most recently published by *The Bond Buyer* or any successor publication set forth below under the longest period specified which does not exceed the duration of such interest rate period:

Interest rate period equal to or longer than (in years)						
<u>15</u>	<u>13</u>	<u>10</u>	<u>7</u>	<u>5</u>	<u>2</u>	<u>1/2</u>
100%	97%	93%	86%	80%	70%	65%

If the interest rate period during which such Market Rate is to be in effect is equal to or less than one-half year, the Market Rate for such interest rate period will be the Municipal Swap Index most recently announced by The Bond Market Association. If either of such indices ceases to be published, the most comparable published index designated by the City is required to be used for such Market Rate determination.

Notwithstanding any higher determination of a Market Rate, the rate of interest to be borne by Bonds in any interest rate period in any mode may not exceed the Maximum Rate. The "Maximum Rate" is the lesser of 15% per annum or (except in an Auction Mode or Fixed Mode) the per annum rate of interest, if any, specified in the Liquidity Facility then in effect under the Ordinance as the rate at which money available to be drawn thereunder to pay interest on the Bonds in the applicable mode has been computed. The initial Liquidity Facility sets the Maximum Rate at 10% per annum.

Conversion of Interest Modes

The City is permitted to change the mode for all or any portion of the Bonds to a different mode or to an Auction Mode or Term Mode with an interest rate period of different duration (and, if the new interest rate mode is an Auction Mode or Term Mode, to designate the duration of the initial interest rate period). The first day of any mode designated by the City is required to be (i) if the mode then in effect for the Bonds to be converted is a Daily Mode or Weekly Mode, a Business Day, (ii) if the mode then in effect for the Bonds to be converted is a Commercial Paper Mode or Auction Mode, the last interest payment date for all interest rate periods for such Bonds then in effect or, in the case of a Commercial Paper Mode, any Business Day thereafter, and (iii) if a Term Mode is then in effect for the Bonds to be converted, any Business Day on which such Bonds may be redeemed at the option of the City as described under "THE BONDS – REDEMPTION OF BONDS – Optional Redemption" herein.

The mode, or the interest rate period during any Auction Mode or Term Mode, for Bonds may only be changed upon notice to the Bondholders as described below. No such change may be made unless (i) there is delivered to the Paying Agent/Registrar on the first day of such mode or interest rate period an opinion of nationally recognized bond counsel stating that the change will not adversely affect any exclusion of interest on any Bond income for federal income tax purposes (unless the change is between any two of a Daily Mode, Weekly Mode, Commercial Paper Mode or Term Mode with an interest period of one year or less), and (ii) by 1:30 p.m., New York, New York, time on the date of such change the Paying Agent/Registrar or the Liquidity Bank has received the purchase price of all Bonds tendered or deemed tendered for purchase on such date in accordance with the procedures set forth below under "THE BONDS – PURCHASE OF BONDS" (or, in the case of a change in the duration of interest rate periods in an Auction Mode, clearing bids are made on the preceding Auction Date).

Determination of Interest Rate Periods

The interest rate period for a Bond during a Commercial Paper Mode will be determined by the Remarketing Agent, will commence on the first day of such mode for such Bond or on the day immediately succeeding the immediately preceding interest rate period for such Bond, and will not be less than one day nor more than 270 days in duration. No such interest rate period in a Commercial Paper Mode may cause the amount of interest due on all Bonds (other than Bonds in an Auction Mode or Fixed Mode) on the next interest payment date for such Bonds to exceed the coverage then afforded by

the Liquidity Facility. In addition, no such interest rate period for any Bond in a Commercial Paper Mode may extend beyond a redemption date for Bonds in the Commercial Paper Mode unless the interest rate periods for at least the amount of the Bonds to be redeemed on such redemption date end on or before such date.

Each interest rate period for a Bond, which is in a Term Mode, will commence on the first day of such Term Mode or on the day after the immediately preceding interest rate period for such Bond during such mode. If the interest rate period for Bonds in a Term Mode is changed by the City as described above under "Conversion of Interest Modes", the initial interest rate period after the change will extend to the February 1 specified by the City which occurs at least two years after the effective date of such mode. Each successive interest rate period during such Term Mode will extend to (a) the anniversary of such date (if the City has not previously changed the interest rate period or interest mode and, either no change to the terms of the Bonds or liquidity or credit support are made in connection with the associated remarketing or in the opinion of nationally recognized bond counsel such change would not adversely affect the tax-exempt status of interest on the Bonds) or (b) if these conditions are not met, the anniversary of such date which occurs the same number of 12-month periods after the first day of such interest rate period as the number of 12-month periods or portions thereof during the previous interest rate period in such Term Mode.

Notice of Interest Rates and Interest Modes

Not less than 20 days if the affected Bonds are then in a Daily Mode, Weekly Mode, or Auction Mode, not less than 30 days if the affected Bonds are then in another mode, and in either case not more than 60 days prior to the effective date of any change in the method of determining the rate determination date (or maximum rate) for any Bond, to the first day of any Daily Mode, Weekly Mode, Commercial Paper Mode, Auction Mode, Term Mode or Fixed Mode for any Bond, or to the first day of any change in the interest rate period for any Bond or portion thereof in an Auction Mode or Term Mode, the City or Paying Agent/Registrar must give notice of such event or events to the registered owners of such Bonds stating that such change will occur and the effective date of such change.

Bondholders may ascertain the current Daily Rate, Weekly Rate, or Commercial Paper Rate for Bonds by contacting the Remarketing Agent, may ascertain the current Auction Rate for Bonds by contacting the Auction Agent, and may ascertain the current Term Rate or Fixed Rate for Bonds by contacting the Paying Agent/Registrar. The Paying Agent/Registrar is required to provide to each beneficial owner of a Bond in a Daily Mode or Weekly Mode, upon request, the interest rates in effect since the preceding interest payment date.

While the Bonds are registered in the name of Cede & Co., as nominee for DTC, the foregoing notices will be given to Cede & Co. only, which alone will be responsible for providing such notices to the beneficial owners. See "THE BONDS – BOND PROVISIONS – Book-Entry-Only System" herein. However, beneficial owners may register to receive such information directly by contacting the Paying Agent/Registrar. See "CONINUING DISCLOSURE OF INFORMATION" herein.

Effect of Determinations

Each designation of a mode or the duration of an interest rate period and each determination of a Daily Rate, Weekly Rate, Commercial Paper Rate, Auction Rate, Term Rate, or Fixed Rate will be conclusive and binding upon the owners of the affected Bonds, and neither the City nor the Remarketing Agent nor the Paying Agent/Registrar will have any liability for any such determination, whether due to any error in judgment, failure to consider any information, opinion, or resource, or otherwise.

If any proposed change in the mode or interest rate period for any Bond designated by the City may not be effected because of any failure to satisfy the conditions to such change contained in the Ordinance, (1) the mode for such Bond will change automatically to the Weekly Mode (unless only the duration of interest periods in an Auction Mode is proposed to be changed, in which case the ensuing interest period will be a weekly period), if the preceding mode for such Bond was a Daily Mode, Weekly Mode, Commercial Paper Mode, or Term Mode with an interest period of one year, or in the opinion of nationally recognized bond counsel such change will not adversely affect any exclusion of interest on any Bond from the gross income of the owner thereof for federal income tax purposes, and (2) otherwise the mode (and the interest rate period in any Auction Mode or Term Mode) then in effect for such Bond will remain unchanged and, except for any tender required by the provisions described below under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender", the owners of the affected Bonds will be restored to their original positions.

PURCHASE OF BONDS

Optional Tender

The beneficial owners of Bonds in a Daily Mode or Weekly Mode will have the right to have their beneficial interests in such Bonds (or portions thereof equal to, and leaving untendered, an authorized denomination) purchased by the Paying Agent/Registrar, at a purchase price equal to 100% of principal amount plus accrued interest (payable from the limited sources of funds described below), as follows:

Daily Mode. While in a Daily Mode, any Bond (or portion thereof) may be tendered to the Paying Agent/Registrar for purchase, as described above, on any Business Day by:

- (1) delivering notice of such tender as described below by telephone, facsimile or other electronic means to the Remarketing Agent by 11:00 a.m., New York, New York, time, on such Business Day; and
- (2) tendering such Bond (or portion) to the Paying Agent/Registrar as described below by 12:00 noon, New York, New York, time, on the purchase date.

Weekly Mode. While in a Weekly Mode, any Bond (or portion thereof) may be tendered to the Paying Agent/Registrar for purchase, as described above, on any Business Day by:

- (1) delivering notice of tender (which shall be irrevocable and effective upon receipt) to the Remarketing Agent and the Paying Agent/Registrar in writing or by facsimile or other electronic means by 4:00 p.m., New York, New York, time, on a Business Day which is at least seven days prior to the purchase date; and
- (2) tendering such Bonds to the Paying Agent/Registrar as described below by 12:00 noon, New York, New York, time, on the purchase date.

Payment for Bonds tendered for purchase is required to be made in immediately available funds by the close of business on the purchase date. Each notice of the optional tender of the Bonds must state the principal amount of the Bonds to be tendered, the mode then in effect for such Bonds, the purchase date, the name of the registered owner (and, while the Bonds are registered in the name of Cede & Co. or any alternate securities depository or its nominee, the name and number of the account to which such Bond is credited by the securities depository). Notice of tender should be delivered to the address of the Remarketing Agent and, if applicable, the Paying Agent/Registrar shown under "CONTACT INFORMATION". The addresses may be changed by notice mailed to the registered owners of the Bonds at their registered addresses.

Mandatory Tender

Each owner of Bonds will be required to tender, and in any event will be deemed to have tendered, such Bonds (or the applicable portion thereof described below) to the Paying Agent/Registrar for purchase at a purchase price equal to 100% of the principal amount plus accrued interest (payable from the limited sources of funds described below), on

Substitution of Liquidity Facility or Credit Facility: the last Business Day on or before any proposed release of the Liquidity Facility (unless such Bonds or portions thereof are in an Auction Mode or the Fixed Mode) or any Credit Facility upon replacement with an alternate Liquidity Facility or Credit Facility at the option of the City (which may only occur on the Business Day following each interest rate period in a Term Mode), as described herein under "STANDBY BOND PURCHASE AGREEMENT – Release and Substitution",

Mode Changes: the first Business Day of each new mode for such Bonds or portions thereof designated by the City, whether or not such new mode is effected,

Rate Adjustment Dates: the first Business Day of each interest rate period for such Bonds or portions thereof while they are in a Commercial Paper Mode or a Term Mode, and

Termination of Liquidity Facility or Credit Facility: the third Business Day prior to the expiration of the Liquidity Facility (unless such Bonds are in an Auction Mode or the Fixed Mode) or any Credit Facility or prior to the date of termination of the obligation of the Liquidity Bank under the Liquidity Facility (unless such Bonds are in an Auction Mode or the Fixed Mode) or the Credit Enhancer under any Credit Facility on advance notice to the

Paying Agent/Registrar, as described herein under "STANDBY BOND PURCHASE AGREEMENT – Release and Substitution".

The Paying Agent/Registrar is required to give notice of mandatory tender (other than mandatory tender at the end of Interest Periods for Bonds in a Commercial Paper Mode) to each registered owner of the Bonds affected thereby by mail, first class postage prepaid, not more than 60 nor less than 20 days, if such Bond is in a Daily Mode, Weekly Mode, or Auction Mode, and not more than 60 nor less than 30 days, if such Bond is in any other mode, prior to each mandatory tender date. While the Bonds are registered in the name of Cede & Co., only Cede & Co. will receive such notice from the Paying Agent/Registrar. See "THE BONDS – BOND PROVISIONS – Book-Entry-Only System" herein. However, beneficial owners may register to receive such information directly by contacting the Paying Agent/Registrar. See "CONTINUING DISCLOSURE OF INFORMATION" herein.

Tender Procedures

While the Bonds are all registered in the name of Cede & Co., as nominee for DTC, Bondholders may tender Bonds for purchase by giving DTC sufficient instructions to transfer beneficial ownership of such Bonds to the account of the Paying Agent/Registrar against payment.

Limitations on Payment of Purchase Price

The Paying Agent/Registrar will be required to effect purchases of tendered Bonds solely from and to the extent of (1) proceeds of the remarketing of such Bonds pursuant to the applicable Remarketing Agreement, or, to the extent such proceeds are insufficient, (2) amounts drawn under or derived from the Liquidity Facility, if such Bonds are eligible for advances thereunder, or, to the extent that such amounts are insufficient, (3) payments, if any, elected to be made by the City in its sole discretion. For additional information regarding the Liquidity Bank's commitment to purchase tendered Bonds, see "STANDBY BOND PURCHASE AGREEMENT" herein. The City will have no obligation and has no intent to purchase tendered Bonds. No purchase right will pertain to Bank Bonds or Bonds registered in the name or held for the benefit or account of the City or certain affiliates.

Under certain circumstances, the Liquidity Bank's obligation to purchase tendered Bonds may terminate or be suspended without prior notice. See "STANDBY BOND PURCHASE AGREEMENT – Termination or Suspension of Commitment" herein. In those circumstances, the right to have Bonds purchased on demand will effectively be suspended.

Untendered Bonds

ANY BOND (OR PORTION THEREOF) WHICH IS REQUIRED TO BE TENDERED AS DESCRIBED UNDER "THE BONDS – PURCHASE OF BONDS – MANDATORY TENDER" ABOVE OR FOLLOWING NOTICE OF TENDER AS DESCRIBED ABOVE UNDER "THE BONDS – PURCHASE OF BONDS – OPTIONAL TENDER" AND FOR WHICH PAYMENT OF THE PURCHASE PRICE IS DULY PROVIDED FOR ON THE RELEVANT PURCHASE DATE WILL BE DEEMED TO HAVE BEEN TENDERED AND SOLD ON SUCH PURCHASE DATE, AND THE HOLDER OF SUCH BOND WILL NOT THEREAFTER BE ENTITLED TO ANY PAYMENT (INCLUDING ANY INTEREST ACCRUED SUBSEQUENT TO SUCH PURCHASE DATE) IN RESPECT THEREOF OTHER THAN THE PURCHASE PRICE FOR SUCH BOND OR PORTION OR OTHERWISE BE SECURED BY OR ENTITLED TO ANY BENEFIT UNDER THE ORDINANCE.

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REDEMPTION OF BONDS

Mandatory Sinking Fund Redemption

The Bonds will be subject to mandatory sinking fund redemption by the City prior to their scheduled maturity at a redemption price equal to 100% of the principal amount thereof, without premium, on the first interest payment date for such Bonds on or after February 1 of the years and in the principal amounts indicated below:

<u>Year</u>	<u>Amount</u>
2029	\$50,000,000
2030	50,000,000
2031	50,000,000
2032	50,000,000
2033	50,000,000 (final maturity)

The City may reduce the amount of Bonds so required to be redeemed on any date by the principal amount of outstanding Bonds which are either (i) purchased and surrendered to the Paying Agent/Registrar by the City for cancellation at least 45 days prior to such date or (ii) selected at least 45 days prior to such date for optional redemption, if in either case such Bonds have not previously served as the basis for any such reduction.

Optional Redemption

The Bonds are subject to redemption prior to their stated maturity at the option of the City in whole or in part, at a redemption price equal to 100% of principal amount plus accrued interest, if any, on (i) any Business Day, if the Bonds to be redeemed bear interest at a Daily Rate or Weekly Rate, (ii) any rate adjustment date for the Bonds to be redeemed, if such Bonds are in a Commercial Paper Mode, Auction Mode, or Term Mode, (iii) the first day of the Fixed Mode for the Bonds to be redeemed, and (iv) any date, for Bank Bonds.

While in a Term Mode or Fixed Mode, Bonds are also subject to redemption prior to their stated maturity at the option of the City in whole or in part on any date after the no-call period shown below following the first day of the applicable interest rate period, at a price equal to 100% of principal amount plus accrued interest:

<u>Interest Rate Period in Term Mode or Fixed Mode</u>		
<u>Equal to or Greater Than</u>	<u>But Less Than</u>	<u>No-Call Period</u>
12 Years	N/A	10 Years
9 Years	12 Years	8 Years
7 Years	9 Years	6 Years
5 Years	7 Years	4 Years
2 Years	5 Years	Prior to the penultimate 12-month period
0 Years	2 Years	1 Year

The City may change the dates and prices for any such redemption prior to the rate determination date for such interest rate period, if the City receives an opinion of nationally recognized bond counsel to the effect that such change will not adversely affect any exclusion of interest on any Bond from gross income for federal income tax purposes.

Mandatory Redemption of Bank Bonds

The City is required to redeem Bank Bonds on the dates and in the amounts required by the Liquidity Facility. While the Standby Bond Purchase Agreement remains in effect, the Bank Bonds must be redeemed in 10 semiannual installments following expiration or termination of the Liquidity Bank's obligation to purchase tendered Bonds.

Redemption Procedures

Notice of each redemption of Bonds is required to be mailed not less than 20 days, if the Bonds to be redeemed are in a Daily Mode, Weekly Mode, or Auction Mode, not less than 30 days, if the Bonds to be redeemed are in any other mode, and in either case not more than 60 days prior to the redemption date to each registered owner of the Bonds to be redeemed at the address of such owner recorded in the bond register. If notice of redemption of any Bond is so given, such Bond (or the principal amount thereof to be redeemed) will be due and payable on the redemption date and, if funds sufficient to pay the redemption price are deposited with the Paying Agent/Registrar on the redemption date, will cease to bear interest after such date. While the Bonds are registered in the name of DTC or its nominee, as nominee for the beneficial owners, the foregoing notice will be given to DTC or such nominee only, which shall alone be responsible for providing such notice to the beneficial owners. See "THE BONDS – BOND PROVISIONS – Book-Entry-Only System" herein. However, beneficial owners may register to receive such notices directly by contacting the Paying Agent/Registrar. See "CONTINUING DISCLOSURE OF INFORMATION".

If less than all outstanding Bonds are to be redeemed, the City will redeem all Bank Bonds before redeeming any other Bonds. Except when held by DTC, its nominee, or any substitute securities depository, if less than all the Bonds (other than Bank Bonds) are to be redeemed, the Paying Agent/Registrar must select at random and by lot the Bonds to be redeemed as provided in the Ordinance.

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SUMMARY OF SHORT-TERM MODES

	Daily Mode	Weekly Mode	Commercial Paper
Interest Payment and Calculation Method¹	First Business Day of month; actual days over 365/366 day year	First Business Day of month; actual days over 365- or 366-day year	First Business Day after each Interest Rate Period; actual days over 365- or 366-day year
Record Date	Day preceding interest payment date	Day preceding interest payment date	Day preceding interest payment date
Authorized Denominations	\$100,000 and integral multiples of \$5,000 in excess thereof	\$100,000 and integral multiples of \$5,000 in excess thereof	\$100,000 and integral multiples of \$5,000 in excess thereof
Rate Determination Date	Each business day for the Remarketing Agent (by 10:00 a.m. New York, New York time)	Each business day for the Remarketing Agent before each Wednesday (by 4:00 p.m., New York, New York, time)	First business day for the Remarketing Agent on or before Interest Rate Period (by 12:30 p.m., New York, New York, time)
Interest Rate Period	From Rate Determination Date to next Rate Determination Date	Wednesday of one week through Tuesday of the following week	Any duration from one to 270 days
Rate Adjustment Date	Each Rate Determination Date	Each Wednesday	First Business Day in each Interest Rate Period
Notice of Interest Rate	Owners may contact the Remarketing Agent to obtain interest rates	Owners may contact the Remarketing Agent to obtain interest rates	Owners may contact the Remarketing Agent to obtain interest rates
Optional Tender Dates	Any Business Day	Any Business Day at least seven days after delivery of notice	None
Notice of Optional Tender	Irrevocable telephone, facsimile or electronic notice of tender to the Remarketing Agent by 11:00 a.m., New York, New York, time, on the Purchase Date	Irrevocable written, facsimile, or electronic notice of tender to the Remarketing Agent and Paying Agent/Registrar by 4:00 p.m., New York, New York, time, on any Business Day not less than seven days prior to the purchase date	None
Mandatory Purchase Date	²	²	Rate Adjustment Date ²
Permissible Optional Redemption Dates	Any Business Day	Any Business Day	Any Rate Adjustment Date
Notice of Mandatory Tender or Redemption	Mailed to DTC by the 20 th day before tender or redemption date	Mailed to DTC by 20 th day before tender or redemption date	Mailed to DTC by 30 th day before tender or redemption date ³

(1) Interest is also payable on the first Business Day after the date of conversion of mode. First interest payment date was June 1, 2003.

(2) The Bonds are subject to mandatory tender upon the events described under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender".

(3) No notice for mandatory tender on Rate Adjustment Date.

BOND PROVISIONS

Authority and Security for the Bonds

The Bonds were issued under the provisions of applicable laws of the State of Texas, including Texas Government Code, Chapters 1371 and 1502, as amended, and the Ordinance.

The Bonds are special obligations of the City payable solely from and equally and ratably secured, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City, by a junior lien on and pledge of the Net Revenues of the Systems, subject and subordinate to liens and pledges securing the outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued, and superior to the pledge and lien securing the currently outstanding Commercial Paper Obligations, all as fully set forth in the Ordinance.

The Ordinance does not create a mortgage or other security interest on the property of the Systems. The Bonds are special obligations of the City, payable, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City only from a junior lien on the pledge of the Net Revenues of the Systems, and the taxing power of neither the City nor the State of Texas is pledged for the payment thereof.

Sources of and Security for Payment

The Bonds are limited obligations of the City. Principal of and interest on the Bonds will be payable solely from and to the extent of Net Revenues of the Systems remaining after monthly payments on and transfers to provide for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations of the Systems outstanding from time to time.

To secure payment of the Bonds, together with the currently outstanding Junior Lien Obligations and the obligations of the City to the Liquidity Bank, in the Ordinance the City has granted a lien on and pledge of Net Revenues of the Systems, subject and subordinate to liens and pledges securing the Senior Lien Obligations now outstanding and any Additional Senior Lien Obligations hereafter issued in accordance with the provisions of the Ordinance, but prior to the lien on and pledge of the Net Revenues covering the payment of the currently outstanding Commercial Paper Obligations. The City has reserved the right to grant equal and ratable liens on and pledges of Net Revenues to secure payment of Additional Junior Lien Obligations hereafter issued in accordance with the Ordinance. See "DEBT SERVICE REQUIREMENTS" and "THE BONDS – BOND PROVISIONS – Additional Bonds" herein, and "APPENDIX C – CERTAIN PROVISIONS OF THE ORDINANCE".

For a description of the sources of payment of the purchase price of Bonds tendered for purchase, see "THE BONDS – PURCHASE OF BONDS – Limitations on Payment of Purchase Price" herein.

Flow of Funds

The Ordinance provides that the gross revenues of the Systems are to be deposited in CPS' General Account, and further provides that such revenues are pledged and appropriated, in the following priority, (i) to the payment of reasonable and proper Maintenance and Operating Expenses of the Systems; (ii) to the payment of Senior Lien Obligations or Additional Senior Lien Obligations, including the establishment and maintenance of the reserve therefor; (iii) to the payment of the currently outstanding Junior Lien Obligations, the Bonds, the City's obligation under the Liquidity Facility, and any Additional Junior Lien Obligations, including the establishment and maintenance of a reserve therefor, if any; (iv) to the payment and security of the Notes and the Agreement (as defined in the ordinance authorizing the Notes); (v) to the payment and security of obligations hereinafter issued which are inferior in lien to the Senior Lien Obligations, Additional Senior Lien Obligations, the Bonds, the currently outstanding Junior Lien Obligations, Additional Junior Lien Obligations, Liquidity Facility obligations, and the Commercial Paper Obligations; (vi) to the payment of an annual amount equal to six percent (6%) of the gross revenues of the Systems to be deposited in the Repair and Replacement Account provided for in the Ordinance; (vii) to the payment of the annual amount due the General Fund of the City, as provided in the Ordinance; and (viii) to the extent of any remaining Net Revenues of the Systems in the General Account, to the Repair and Replacement Account to the extent provided in the Ordinance. Any remaining Net Revenues after making or providing for the foregoing payments and deposits may be used for any other purpose of the Board.

Rate Covenant

The City has covenanted in the Ordinance that it will at all times maintain rates and charges for the sale of electric energy, gas, or other services furnished, provided and supplied by the Systems to the City and all other consumers which will be reasonable and nondiscriminatory and which will be reasonably expected to produce gross revenues sufficient to pay all expenses of maintenance and operation of the Systems, and to produce Net Revenues sufficient, together with other lawfully available funds, to pay debt service requirements on all revenue debt of the Systems, including Senior Lien Obligations, any Additional Senior Lien Obligations, the Bonds, the currently outstanding Junior Lien Obligations, Liquidity Facility obligations, Additional Junior Lien Obligations, the Commercial Paper Obligations, and any Inferior Lien Obligations hereafter issued. The CPS rate covenant is consistent with and supported by the relevant State statute concerning rate setting for municipally-owned utilities ("Municipal Utilities") such as CPS. Section 1502.057, as amended, Texas Government Code, provides that the charges for services provided by encumbered municipal systems, such as CPS, must be "at least sufficient to pay: all operating, maintenance, depreciation, replacement, improvement and interest charges in connection with the utility system; for an interest and sinking fund sufficient to pay any public securities issued or obligations incurred for any purpose...relating to the utility system; and any outstanding debt against the system".

This statute could be amended or repealed by the Texas Legislature. See "APPENDIX C – CERTAIN PROVISIONS OF THE ORDINANCE". Also, see "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Retail Service Rates and – Transmission Access and Rate Regulation" regarding rate regulation herein.

Additional Bonds

The City may issue Additional Senior Lien Obligations on a parity with the currently outstanding Senior Lien Obligations if, among other things, it has obtained a certificate from an independent certified public accountant to the effect that the Net Revenues of the Systems during the previous fiscal year, or any 12 consecutive months out of the 15 months immediately preceding the month in which the ordinance authorizing the Additional Senior Lien Obligations is passed, were (i) at least 1.50 times the maximum annual debt service requirements in any future fiscal year on all outstanding Senior Lien Obligations and the proposed Additional Senior Lien Obligations and (ii) at least 1.00 times the maximum annual debt service requirements for any future fiscal year for Senior Lien Obligations, Additional Senior Lien Obligations, and Junior Lien Obligations (including the Bonds, the outstanding Junior Lien Obligations, the Liquidity Facility obligations and any Additional Junior Lien Obligations) to be outstanding, assuming that variable rate interest accrues at *The Bond Buyer's* Revenue Bond Index with respect to the Junior Lien Obligations and adding or subtracting net payments due on or receivable under interest rate hedge agreements, if any.

The City may issue Additional Junior Lien Obligations if the Board's General Manager and Chief Executive Officer ("CEO") or Chief Financial Officer ("CFO") certifies that the Net Revenues of the Systems during the previous fiscal year, or any 12 consecutive months out of the 18 months immediately preceding the month in which the ordinance authorizing such obligations is passed, were at least 1.00 times the average annual debt service requirements for any future fiscal year for Senior Lien Obligations, Additional Senior Lien Obligations, and Junior Lien Obligations (including the Bonds and Liquidity Facility obligations and Additional Junior Lien Obligations) to be outstanding, assuming that variable rate interest accrues at *The Bond Buyer's* Revenue Bond Index with respect to the Junior Lien Obligations and adding or subtracting net payments due on or receivable under interest rate hedge agreements, if any.

Perfection of Security for the Bonds

Chapter 1208, as amended, Texas Government Code, applies to the issuance of the Bonds and the pledge of the Net Revenues, and such pledge is therefore valid, effective and perfected. Should State law be amended while the Bonds are outstanding and unpaid, the result of such amendment being that the pledge of the Net Revenues is to be subject to the filing requirements of Chapter 9, Texas Business and Commerce Code, in order to preserve to the registered owners of the Bonds a security interest in such pledge, the City agrees to take such measures as it determines are reasonable and necessary to enable a filing of a security interest in said pledge to occur.

Amendments

The City may, without the consent of or notice to any Holders, from time to time and at any time, amend the Ordinance in any manner not detrimental to the interest of the Holders, including the curing of any ambiguity, inconsistency, or formal defect or omission therein. In addition, the City may, with the written consent of Holders holding a majority in aggregate principal amount of the Bonds then Outstanding affected thereby, amend, add to, or rescind any of the provisions of the

Ordinance; provided that, without the consent of all Holders of Outstanding Bonds, no such amendment, addition, or rescission shall (1) extend the time or times of payment of the principal of and interest on the Bonds, reduce the principal amount thereof or the rate of interest thereon, or in any other way modify the terms of payment of the principal of or interest on the Bonds, (2) give any preference to any Bond over any other Bond, or (3) reduce the aggregate principal amount of Bonds required for consent to any such amendment, addition, or rescission.

Defeasance

The Ordinance provides for the defeasance of the Bonds when payment of the principal of and premium, if any, on the Bonds, plus interest thereon to the due date thereof (whether such due date be by reason of maturity, redemption, or otherwise) is provided by irrevocably depositing with a paying agent in trust (i) money in an amount sufficient to make such payment and/or (ii) Government Securities certified by an independent public accounting firm of national reputation or other legally permitted person to mature as to principal and interest in such amounts and at such times to insure the availability, without reinvestment, of sufficient money to make such payment, and all necessary and proper fees, compensation and expenses of the paying agent for the Bonds. The Ordinance provides that "Government Securities" means (i) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America, (ii) non-callable obligations of an agency or instrumentality of the United States of America, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent, and (iii) non-callable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that are rated as to investment quality by a nationally recognized investment rating firm not less than "AAA" or its equivalent.

Upon such deposit as described above, such Bonds shall no longer be regarded to be outstanding or unpaid. Provided, however, the City has reserved the option, to be exercised at the time of the defeasance of the Bonds, to call for redemption at an earlier date those Bonds which have been defeased to their maturity date, if the City (i) in the proceedings providing for the firm banking and financial arrangements, expressly reserves the right to call the Bonds for redemption, (ii) gives notice of the reservation of that right to the owners of the Bonds immediately following the making of the firm banking and financial arrangements, and (iii) directs that notice of the reservation be included in any redemption notices that it authorizes.

Registered Owners' Remedies

If the City defaults in the payment of principal, interest, or redemption price on the Bonds when due, or if it fails to make payments into any fund or funds created in the Ordinance, or defaults in the observation or performance of any other covenants, conditions, or obligations set for in the Ordinance, the registered owners may seek a writ of mandamus to compel City officials to carry out their legally imposed duties with respect to the Bonds, if there is no other available remedy at law to compel performance of the Bonds or Ordinance and the City's obligations are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles, so rests with the discretion of the court, but may not be arbitrarily refused. There is no acceleration of maturity of the Bonds in the event of default and, consequently, the remedy of mandamus may have to be relied upon from year to year. The Ordinance does not provide for the appointment of a trustee to represent the interest of the bondholders upon any failure of the City to perform in accordance with the terms of the Ordinance, or upon any other condition and accordingly all legal actions to enforce such remedies would have to be undertaken at the initiative of, and be financed by, the registered owners. On June 30, 2006, the Texas Supreme Court ruled in *Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006) that a waiver of sovereign immunity in a contractual dispute must be provided for by statute in "clear and unambiguous" language. Because it is unclear whether the Texas legislature has effectively waived the City's sovereign immunity from a suit for money damages, bondholders may not be able to bring such a suit against the City for breach of the Bonds or the Ordinance covenants. Even if a judgment against the City could be obtained, it could not be enforced by direct levy and execution against the City's property. Furthermore, the City is eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues (such as the Net Revenues), such provision is subject to judicial construction. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or bondholders of an entity which has sought protection under Chapter 9. Therefore, should the City avail itself of Chapter 9 protection from creditors, the ability to enforce would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinion of Bond Counsel will note that all opinions relative to the enforceability of the Ordinance and the Bonds are qualified with respect to the customary rights of debtors relative to their creditors.

Book-Entry-Only System

This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by DTC while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry-Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The City believes the source of such information to be reliable, but takes no responsibility for the accuracy or completeness thereof.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each beneficial owner of the Bonds is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase. Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the beneficial owner entered into the transaction. Transfers of ownership interest in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the beneficial owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, beneficial owners of the Bonds may wish to ascertain that the nominee holding Bonds for their benefit has agreed to obtain and transmit notices to beneficial owners. In the alternative, beneficial owners may wish to provide their names and addresses to the Paying Agent/Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or the Paying Agent/Registrar, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Paying Agent/Registrar or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, principal, and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the beneficial owners shall be the responsibility of Direct and Indirect Participants.

A beneficial owner shall give notice to elect to have its Bonds purchased or tendered, through its Participant, to the Paying Agent/Registrar, and shall effect delivery of such Bonds by causing the Direct Participant to transfer the Participant's interest in the Bonds, on DTC's records, to the Paying Agent/Registrar. The requirement for physical delivery of the Bonds in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Bonds to the Paying Agent/Registrar's DTC account.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the City and the Paying Agent/Registrar acting as Tender Agent. Under such circumstances, in the event that a successor depository is not obtained, the Bonds are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, the Bonds will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

So long as Cede & Co. is the registered owner of the Bonds, the City will have no obligation or responsibility to the DTC Participants or Indirect Participants, or the persons for which they act as nominees, with respect to payment to or providing of notice to such Participants, or the persons for which they act as nominees.

Use of Certain Terms in Other Sections of this Official Statement

In reading this Official Statement it should be understood that while the Bonds are in the Book-Entry-Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Direct or Indirect Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) except as described above, notices that are to be given to registered owners under the Ordinance will be given only to DTC.

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STANDBY BOND PURCHASE AGREEMENT

Purchase Commitment

In connection with the issuance of the Bonds, the City entered into a Standby Bond Purchase Agreement, as amended, with the Bank. Under the Standby Bond Purchase Agreement, the Bank agrees, for the term and on the conditions described therein, to purchase on the required purchase date, at the purchase price described herein, all Bonds then tendered for purchase pursuant to the provisions described herein under "THE BONDS – PURCHASE OF BONDS" to the extent that proceeds of the remarketing of such Bonds pursuant to the Remarketing Agreement have not been timely received by the Paying Agent/Registrar for such purpose.

The Bank is not obligated to pay the principal or redemption price of or interest on the Bonds under any circumstances, but is obligated only to purchase tendered Bonds on and subject to the terms, provisions, and conditions of the Standby Bond Purchase Agreement.

The Bank's commitment to purchase tendered Bonds under the Standby Bond Purchase Agreement on any day is limited to a principal amount of Bonds equal to the initial aggregate principal amount of the Bonds, less the amount of Bonds previously redeemed or purchased by the Bank pursuant to the Standby Bond Purchase Agreement, plus the amount of Bank Bonds remarketed by the Remarketing Agent. The aggregate purchase price of Bonds committed to be purchased by the Bank may not exceed the principal amount of the Bonds plus 35 days' interest thereon at 10% per annum or, with the prior written consent of the Bank, plus 270 days' interest thereon at 10% per annum upon conversion of the Bonds to the Commercial Paper Mode.

The Bank is not obligated to purchase tendered Bonds under the Standby Bond Purchase Agreement unless it receives proper demand from the Paying Agent/Registrar in accordance with the Standby Bond Purchase Agreement. The Paying Agent/Registrar has agreed to make such demand as required.

Termination or Suspension of Commitment

The Bank's commitment to purchase tendered Bonds pursuant to the Standby Bond Purchase Agreement will terminate immediately, with no prior notice to the Paying Agent/Registrar or any owner of Bonds, and thereafter the Bank will not be obligated to purchase tendered Bonds thereunder, if any scheduled principal or interest due on the Bonds is not paid by the City when due.

The Bank may give notice to the City, the Paying Agent/Registrar and the Remarketing Agent requesting a mandatory tender of the Bonds as described herein under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender" if certain other events of default described in the Standby Bond Purchase Agreement occur. The Bank's commitment to purchase tendered Bonds will terminate on the 45th day after the Paying Agent/Registrar's receipt of such notice.

Release and Substitution

The Standby Bond Purchase Agreement or any substitute Liquidity Facility may be amended by the City, or an alternate Liquidity Facility may be accepted by the Paying Agent/Registrar at the request of the City in lieu of the Standby Bond Purchase Agreement or any substitute Liquidity Facility, on conditions described in the Ordinance. As a precondition to any substitution of the Liquidity Facility, Bonds must be purchased as described under "THE BONDS – PURCHASE OF BONDS – Mandatory Tender". The Paying Agent/Registrar must give DTC (and any beneficial owner that registers with the Paying Agent/Registrar to receive notices) at least 20 days advance notice of such mandatory purchase and 10 business days notice of an extension or amendment to the Liquidity Facility, see "CONTINUING DISCLOSURE OF INFORMATION" herein.

The Bank's commitment to purchase Bonds under the Standby Bond Purchase Agreement, as amended, will expire on January 31, 2012, unless extended by agreement of the Bank and the City.

The Bank

For certain information with respect to the Bank, see APPENDIX E – THE LIQUIDITY BANK.

REMARKETING AGREEMENT

Pursuant to the terms of a remarketing agreement ("Remarketing Agreement"), the City has appointed Lehman Brothers Inc. as remarketing agent ("Remarketing Agent") for the Bonds. The Remarketing Agent is obligated to use its best efforts to remarket Bonds whenever they are tendered for purchase, subject to certain conditions, in consideration of the payment by the City of a quarterly fee based upon the principal amount of Bonds outstanding from time to time. When Bonds are remarketed in connection with the conversion of the interest rate to a different mode, the Remarketing Agreement provides that the City and the Remarketing Agent will agree to a fee specifically for such a remarketing. The Remarketing Agent has also agreed to perform the functions of rate-setting agent for the Bonds by determining the interest rates on, and interest periods for, the Bonds in the manner and for the times specified in the Ordinance.

In the Remarketing Agreement, the City has agreed to indemnify the Remarketing Agent, to the extent permitted by applicable law, against certain losses and liabilities, including liabilities that may arise under Federal or State securities laws. The Remarketing Agent may resign or be removed at any time and discharged of its duties upon the direction of the City, upon at least 30 days' prior written notice. In such an event the City has agreed to promptly cause the Paying Agent/Registrar to give notice to bondholders and the rating agencies that assigned ratings to the Bonds of any such removal or resignation. Any successor Remarketing Agent must meet the qualifications set forth in the Ordinance.

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DEBT SERVICE REQUIREMENTS

The following schedule reflects total principal and interest requirements on all outstanding Senior Lien Obligations and the annual debt service requirements on the Bonds and the currently outstanding Junior Lien Obligations. Debt service on Notes issued under the Commercial Paper Program is excluded. See "COMMERCIAL PAPER PROGRAM" herein.

Outstanding Senior Lien Obligations and Junior Lien Obligations

Year Ending February 1,	Total Senior Lien Obligations ¹	Junior Lien Obligations		Total Senior and Junior Lien Obligations ⁵
		Series 2003 Debt Service ^{1, 2, 4}	Series 2004 Debt Service ^{1, 3, 4}	
2008.....	\$ 289,690,463	\$ 10,000,000	\$ 5,573,500	\$ 305,263,963
2009.....	301,246,891	10,000,000	6,280,000	317,526,891
2010.....	290,424,240	10,000,000	6,280,000	306,704,240
2011.....	296,299,208	10,000,000	6,280,000	312,579,208
2012.....	301,874,620	10,000,000	6,280,000	318,154,620
2013.....	290,649,875	10,000,000	6,280,000	306,929,875
2014.....	291,796,281	10,000,000	6,280,000	308,076,281
2015.....	241,247,519	10,000,000	6,280,000	257,527,519
2016.....	236,478,419	10,000,000	6,280,000	252,758,419
2017.....	217,740,825	10,000,000	6,280,000	234,020,825
2018.....	206,826,363	10,000,000	6,280,000	223,106,363
2019.....	234,406,113	10,000,000	6,280,000	250,686,113
2020.....	227,912,582	10,000,000	6,280,000	244,192,582
2021.....	215,712,447	10,000,000	6,280,000	231,992,447
2022.....	211,030,697	10,000,000	6,280,000	227,310,697
2023.....	211,044,550	10,000,000	6,280,000	227,324,550
2024.....	211,032,250	10,000,000	45,530,000	266,562,250
2025.....	211,038,000	10,000,000	43,960,000	264,998,000
2026.....	32,876,500	10,000,000	42,390,000	85,266,500
2027.....	32,873,250	10,000,000	40,820,000	83,693,250
2028.....	32,876,750	10,000,000	0	42,876,750
2029.....	32,873,750	60,000,000	0	92,873,750
2030.....	32,876,500	58,000,000	0	90,876,500
2031.....	32,876,500	56,000,000	0	88,876,500
2032.....	32,875,500	54,000,000	0	86,875,500
2033.....	0	52,000,000	0	52,000,000
Totals.....	\$4,716,580,093	\$490,000,000	\$272,473,500	\$5,479,053,593

(1) Senior Lien Obligations outstanding and Junior Lien Obligations outstanding represent the debt service requirements for total outstanding debt payable from and secured by the Net Revenues of the Systems, excluding debt service with respect to the Commercial Paper Program. See "COMMERCIAL PAPER PROGRAM".

(2) Assumes redemption in accordance with mandatory sinking fund requirements, but no redemption of the Bonds purchased by the liquidity bank. If the Bonds purchased by the liquidity bank are not remarketed by the end of the bank's commitment period, they must be redeemed in ten semiannual installments. Also assumes interest rate expense at 4% per annum. Actual interest rates are set weekly, as long as the Bonds remain in a weekly rate mode, and will differ.

(3) Assumes redemption in accordance with mandatory sinking fund requirements, but no redemption of the 2004 Junior Lien Obligations purchased by the liquidity bank. If the 2004 Junior Lien Obligations purchased by the liquidity bank are not remarketed by the end of the bank's commitment period, they must be redeemed in eight semiannual installments. Interest on the 2004 Junior Lien Obligations is calculated at 4% per annum for purposes of illustration. Actual interest rates will be variable after the initial interest rate period and will differ.

(4) If the Bonds and the 2004 Junior Lien Obligations were to bear interest at the rate of 10% per annum (which is the maximum interest rate unless the supporting liquidity facilities are amended), maximum total annual debt service requirements would increase from \$317,126,383 to \$341,546,383, in the fiscal year ending February 1, 2012.

(5) Based upon the assumptions noted above.

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Historical Net Revenues and Coverage

(Dollars in Thousands)

	Fiscal Years Ended January 31,				
	2003	2004	2005	2006	2007
Gross Revenues ¹	\$ 1,271,656	\$ 1,526,904	\$ 1,473,254	\$ 1,754,927	\$ 1,822,230
Maintenance & Operating Expenses	740,161	942,471	882,509	1,057,035	1,103,128
Available For Debt Service	<u>\$ 531,495</u>	<u>\$ 584,433</u>	<u>\$ 590,745</u>	<u>\$ 697,892</u>	<u>\$ 719,102</u>
Actual Principal and Interest Requirements:					
Senior Lien Obligations ²	<u>\$ 211,831</u>	<u>\$ 230,250</u>	<u>\$ 245,984</u>	<u>\$ 256,442</u>	<u>\$ 271,931</u>
Junior Lien Obligations ³	<u>\$ 0</u>	<u>\$ 2,111</u>	<u>\$ 4,386</u>	<u>\$ 10,964</u>	<u>\$ 15,006</u>
ACTUAL COVERAGE- Senior Liens ..	2.51x	2.54x	2.40x	2.72x	2.64x
ACTUAL COVERAGE- Senior and Junior Liens	2.51x	2.52x	2.36x	2.61x	2.51x
PRO FORMA MADS COVERAGE					
Senior Lien ⁴	1.76x	1.94x	1.96x	2.31x	2.38x
Senior and Junior Liens ⁵	1.55x	1.71x	1.72x	2.04x	2.10x

(1) Calculated in accordance with the Bond Ordinances.

(2) Net of accrued interest where applicable.

(3) The Bonds were issued May 15, 2003 in the principal amount of \$250,000,000 and the Series 2004 Junior Lien Obligations were issued on November 18, 2004 in the principal amount of \$160,000,000. Based on actual adjustable monthly interest payments.

(4) Maximum annual debt service on Senior Lien Obligations.

(5) Maximum annual debt service on Senior Lien Obligations and Junior Lien Obligations and the Bonds is based on the footnoted assumptions under "Outstanding Senior Lien Obligations and Junior Lien Obligations", footnote 4, on the preceding page.

JUNIOR LIEN OBLIGATIONS

On May 15, 2003, the City issued the Bonds in the original principal amount of \$250,000,000 as Junior Lien Obligations ("2003 Junior Lien Obligations") to fund certain capital infrastructure improvements to the Systems and costs of issuance. The 2003 Junior Lien Obligations currently carry an adjustable rate of interest that resets weekly. The final maturity date on any remaining outstanding principal of and interest on the Junior Lien Obligations issued in May 2003 is February 1, 2033.

On November 18, 2004, the City issued \$160,000,000 as Junior Lien Obligations ("2004 Junior Lien Obligations") to acquire an additional 300 megawatts of electric generating capacity in the South Texas Project ("STP"). See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - South Texas Project". In addition, the 2004 Junior Lien Obligations were issued to make other improvements to the Systems and to pay for costs of issuance. On December 1, 2005, the 2004 Junior Lien Obligations were remarketed in the principal amount of \$157,000,000, in a Term Mode, with a two-year interest rate period and a mandatory tender date of December 1, 2007 and a final maturity date of December 1, 2027. While bearing interest in a Term Mode, the interest on the Bonds is payable semi-annually on June 1 and December 1 commencing June 1, 2006.

Currently, \$407,000,000 in aggregate principal amount of Junior Lien Obligations remain outstanding. The mode for Junior Lien Obligations or any portion thereof may be converted to a different mode, or to an auction rate or term rate with an interest rate period of different duration, at the direction of the City. Following such a conversion, the Junior Lien Obligations or portion thereof, will bear interest at the corresponding daily rate, weekly rate, auction rate, commercial paper rate, term rate, or fixed rate. In connection with the issuance of each series of the Junior Lien Obligations, the City enhanced the liquidity of the Junior Lien Obligations by providing for the purchase of the Junior Lien Obligations that are not remarketed by the remarketing agents through two separate Standby Bond Purchase Agreements, with two different banks. These banks, with respect to the series of Junior Lien Obligation each bank is enhancing, are not obligated to pay the principal or redemption price of or interest on the Junior Lien Obligations under any circumstances, but are obligated only to purchase tendered Junior Lien Obligations on and subject to the terms, provisions, and conditions of each bank's respective Standby Bond Purchase Agreement.

The borrowings from the Junior Lien Obligations are equally and ratably secured by and are payable from the Net Revenues of the Systems, such pledge being subordinate and inferior to the pledge of Net Revenues securing the Senior Lien Obligations, but prior and superior to the lien on and pledge of the Net Revenues securing the payment of the Commercial Paper Obligations. The obligations of the City under the two Standby Bond Purchase Agreements are secured

on a parity basis with the pledge of the Net Revenues that secures the Junior Lien Obligations and the Bonds. See "RESPONSE TO COMPETITION – Debt and Asset Management Program" and "CONSTRUCTION PROGRAM".

COMMERCIAL PAPER PROGRAM

Pursuant to authorization from the City, CPS maintains a Commercial Paper Program to provide tax-exempt financing for various purposes. The Commercial Paper Program, which has been amended numerous times since its inception in 1983, and most recently amended and restated on June 26, 1997, currently is authorized to have Notes outstanding thereunder in an aggregate principal amount not to exceed \$450,000,000. A revolving credit agreement, as amended, with a consortium of banks ("Credit Agreement") permits CPS to borrow up to an aggregate amount not to exceed \$450,000,000 for the purpose of paying amounts due under the Commercial Paper Program. CPS may not have more than \$450,000,000 in principal amount of Notes outstanding unless the Credit Agreement is amended or a substitute agreement is entered into to provide liquidity for such increased amount. As of the date of this Remarketing Memorandum \$350,000,000 in aggregate principal amount of Notes was outstanding.

The purpose of the Commercial Paper Program is (i) to assist in the financing of capital improvements to the Systems; (ii) to provide working capital and funds for fuel acquisition; (iii) to pay interest on resold Notes; (iv) to refund outstanding Notes on maturity; and (v) to redeem other obligations of the Systems which are secured by and payable from a lien on and/or a pledge of Net Revenues of the Systems. Scheduled maturities of the Notes may not extend past November 1, 2028 (the Stated Maturity Date specified in the Ordinance authorizing the Commercial Paper Program.) See "RESPONSE TO COMPETITION – Debt and Asset Management Program" and "CONSTRUCTION PROGRAM" herein.

The borrowings under the Commercial Paper Program, including the Notes, are equally and ratably secured by and are payable from (i) the Net Revenues of the Systems, such pledge being subordinate and inferior to the pledge of Net Revenues securing the Senior Lien Obligations, the Bonds, and the currently outstanding Junior Lien Obligations; (ii) the proceeds from the sale of additional bonds issued for that purpose or borrowings under the Commercial Paper Program; and (iii) borrowings under and pursuant to the Credit Agreement. The obligations of the City under the Credit Agreement are secured on a parity basis with the pledge of the Net Revenues that secures the Notes and constitute the Commercial Paper Obligations.

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SAN ANTONIO ELECTRIC AND GAS SYSTEMS

History and Management

The City acquired its electric and gas utilities in 1942 from the American Light and Traction Company, which had been ordered by the federal government to sell properties under provisions of the Holding Company Act of 1935. The bond ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, Junior Lien Obligations and Commercial Paper Notes establish management requirements and provide that the complete management and control of the Systems is vested in the Board. The Mayor of the City is a voting member of the Board, represents the City Council, and is charged with the duty and responsibility of keeping the City Council fully advised and informed at all times of any actions, deliberations, and decisions of the Board and its conduct of the management of the Systems. The present members of the Board are:

<u>Name</u>	<u>Profession</u>	<u>Originally Appointed to the Board</u>	<u>Present Term Expires¹</u>
Stephen S. Hennigan, Chairman	Executive Vice President, San Antonio Federal Credit Union	June 1, 2001	January 31, 2011
Aurora Geis, Vice Chairman	Director, Fannie Mae San Antonio Partnership Office	March 28, 2002	January 31, 2012
Alvaro Sanchez, Jr., Trustee	United States Army, Retired Civil Service (US Air Force), Retired	March 4, 1999	January 31, 2009
Clayton T. Gay Jr., Trustee	Certified Public Accountant, Sole Proprietor	February 1, 1998	January 31, 2008
Phil Hardberger, Ex-Officio Member	Mayor, City of San Antonio	June 7, 2005	May 31, 2009

(1) Aurora Geis was reappointed to a second five-year term on November 20, 2006; Alvaro Sanchez, Jr., Clayton T. Gay Jr., and Stephen S. Hennigan are currently serving their second term. Mayor Phil Hardberger was re-elected on May 12, 2007 and accordingly is not eligible to serve as Mayor beyond his term that will expire on May 31, 2009.

Vacancies in membership on the Board are filled by majority vote of the remaining members. New Board appointees must be approved by a majority vote of the City Council. A vacancy in certain cases may be filled by the City Council. The members of the Board are eligible for re-appointment at the expiration of their first five-year term of office to one additional term. In 1997, the City Council ordained that Board membership should be representative of the geographic quadrants established by the City Council. New Board members considered for approval by the City Council will be those whose residence is in a quadrant that provides such geographic representation.

The Board is vested with all of the powers of the City with respect to the management and operation of the Systems and the expenditure and application of the revenues therefrom, including all powers necessary or appropriate for the performance of all covenants, undertakings, and agreements of the City contained in the bond ordinances, except regarding rates, condemnation proceedings, and issuance of bonds, notes, or commercial paper. The Board has full power and authority to make rules and regulations governing the furnishing of electric and gas service and full authority with reference to making extensions, improvements and additions to the Systems, and to adopt rules for the orderly handling of CPS' affairs. It is empowered to appoint and employ all officers and employees and must obtain and keep in force a "blanket" type employees' fidelity and indemnity bond covering losses in the amount of not less than \$100,000.

The management provisions of the bond ordinances also grant the City Council authority to review Board action with respect to policies adopted relating to research, development, and planning.

Citizens Advisory Committee

In 1997, CPS established a 15-member Citizens Advisory Committee ("CAC") to enhance its relationship with the community and to address the City Council's goals regarding broader community involvement with CPS. The CAC meets monthly and the primary goal of the CAC is to provide recommendations from the community on the operations of CPS for use by the Board and CPS staff. Representing the various sectors of CPS' service area, the CAC encompasses a broad range of customer groups in order to identify their concerns and understand their issues.

Administration and Operating Personnel

CPS had 3,789 employees as of January 31, 2007. The average tenure of a CPS employee is over 14 years. The vast majority of all executive and supervisory personnel have been schooled and trained in the utility industry. CPS employees have a broad range of benefits, including a defined benefit pension plan, group life insurance, hospitalization, major medical and other benefits. Generally good working conditions have produced a stable, well-qualified, highly motivated work force, which between February 1, 2006 and January 31, 2007 recorded an average turnover rate of 3.23%. There are approximately 1,902 hourly employees in the CPS work force and the International Brotherhood of Electrical Workers represents approximately 1,282 employees. As a municipal entity, these employees of CPS may not strike or collectively bargain with CPS; however, to foster an amenable working relationship with these employees, CPS management confers with representatives of these employees on matters pertaining to working conditions and wages.

CPS links an employee incentive compensation plan to employee participation in controlling expenses, promoting safety, maintaining low utility bills, attaining environmental goals, and enhancing customer satisfaction. The Executive Incentive Plan, established in 1997, provides links between CPS' competitiveness and each executive's compensation. Incentive plans were implemented for the entire salaried work force in 1998 and for the entire wage-scale (hourly) workforce in 2003.

CPS continues to enhance an executive Performance Management System implemented in the summer of 1998. A Performance Management System was implemented for salaried employees in June 2001. The Performance Management System established a process that develops and emphasizes facilitative leadership, and engages all employees in actively working toward key shared organizational and business unit strategies and objectives. The process is designed to provide for continual monitoring and a high level of coaching and feedback to reach performance expectations, to provide meaningful developmental opportunities, to emphasize how results are achieved, and to reward and recognize contributions toward business goals. The traditional employee annual review process and cost-of-living driven pay system have been replaced with an enhanced performance assessment process, market-based salaries, and incentive awards based on CPS' overall performance. In addition, CPS is actively engaged in comprehensive Workforce Development and Succession Planning processes to promote wider development opportunity for all employees to learn and grow. These processes are based on the foundational ideas that all employees are expected to develop to their maximum capabilities and that succession planning must focus on ensuring that key positions in the organization are always staffed by employees who have the capacity to keep the company operating at its highest level of productivity.

In the fall of 2006, CPS announced plans for a major organizational redesign of CPS' management. This redesign is focused on preparing CPS for the competitive deregulated market that it may be required to enter in the future. By developing an optimal management structure, CPS wants to ensure its continued success in the competitive deregulated environment. The first phase of the organizational redesign plan began on November 21, 2006. CPS announced the creation of a senior management "Strategy Development Team". The goal of this management team is to concentrate on corporate strategies for CPS' continued success. Reporting directly to the Strategy Development Team is a management team that will focus on strategy implementation. The "Strategy Implementation Team" will concentrate on transforming strategic plans into operational processes and actions. Phase one of the redesign was completed with the selection of the members to the Strategy Implementation Team on February 7, 2007. Phase two of the organizational redesign has begun and will focus on the development of CPS' lower level management and supervisory positions. This second phase is scheduled to be completed in September 2007.

CPS' principal executives and members of the Strategy Development Team are as follows: Milton B. Lee, General Manager and CEO; Richard E. Williamson, Executive Vice President, Chief Financial Officer and Treasurer; Alfonso R. Lujan, Executive Vice President for Energy Delivery and Solutions; Michael K. Kotara, Executive Vice President for Energy Development; Stephen L. Bartley, Executive Vice President for Strategy and External Relations, Carolyn E. Shellman, Senior Vice President and General Counsel, Paula Gold-Williams, Vice President and Chief Administrative Officer, and Christopher C. Barron, Vice President and Chief Information Officer.

Mr. Lee has been an employee of CPS since July 2000. During his 31 years of utility experience prior to joining CPS, he served with the Public Utility Commission of Texas, the City of Austin as General Manager of Austin's electric utility, and the Lower Colorado River Authority, prior to becoming Senior Vice President for Electric Transmission and Distribution Systems at CPS. He was appointed the General Manager and CEO for CPS on January 28, 2002.

Mr. Williamson has been an employee of CPS since 1970 and he has served as Supervisor of Budget Administration, Supervisor of Financial Reporting and Analysis, Supervisor of Cash Management, Supervisor of Financial Management and Treasury Programs, Supervisor of Investment and Trust Analysis, Director of Finance, Vice President of Financial Services and Senior Vice President of Financial Services and Chief Financial Officer, prior to his current position as Executive Vice President and Chief Financial Officer. Mr. Williamson is responsible for the budgeting, finance, accounting, risk management, and the financial operations of CPS. Mr. Williamson also serves as Treasurer for the Board.

Mr. Lujan joined CPS in September 2003 as Senior Vice President for Energy Delivery Services and he currently holds the position of Executive Vice President for Energy Delivery and Solutions. During his 35 years in the utility industry, he served as Vice President of Electric Service Delivery at Public Service Company of New Mexico and Senior Vice President of Electric Service Delivery, as well as Chief Operating Officer of the City of Austin's electric utility. Mr. Lujan is responsible for CPS' energy delivery services, engineering services, operations support, operations and maintenance, planning and reliability, retail operations and strategic marketing.

Mr. Kotara has been an employee of CPS since 1985, and has held several leadership positions including Director of Gas Engineering, Director of Marketing, Director of Generation Control & Marketing, Director of Fuels, Vice President of the Gas Business Unit, and Vice President of Wholesale Energy Markets. In his current role as Executive Vice President of Energy Development, Mr. Kotara is responsible for all aspects of power generation including engineering, operations, maintenance, construction and nuclear generation oversight as well as generation planning, wholesale energy market operations and marketing, fuels supply, fuels hedging and environmental services.

Mr. Bartley joined CPS in September 2000 and has served as Director of Governmental Relations and Vice President of Governmental and Regulatory Relations prior to his current position as Executive Vice President for Strategy and External Relations. During his 29 years in the utility industry, he has held several senior management positions for the Lower Colorado River Authority and Austin Energy. As the Executive Vice President for Strategy and External Relations, he is responsible for CPS' business strategy process, community relations, corporate communications, governmental relations and regulatory relations.

Ms. Shellman joined CPS in July 2006. Ms. Shellman comes to CPS with over 25 years as an attorney in the utility industry. She previously served as General Counsel and Secretary for the Electric Reliability Council of Texas ("ERCOT"). Prior to that she served as a partner in the utility sections of two separate Texas law firms. Ms. Shellman has also served as the Director for the Hearings Section of the Public Utility Commission of Texas ("PUCT") and as a hearing officer with the PUCT. As CPS' General Counsel she focuses on state and federal laws and regulations affecting CPS.

Ms. Gold-Williams joined CPS in October 2004 and has served as Controller prior to her current position as Vice President and Chief Administrative Officer. Ms. Gold-Williams is responsible for the major areas of human resources, supply chain and facilities. Prior to joining CPS, she held several senior management positions at other companies.

Mr. Barron joined CPS in November 2004 and has served as Director of Information Technology Services and Director of Enterprise Applications and E-Commerce prior to his current position as Vice President and Chief Information Officer. During his 17 years in information technology, Mr. Barron has headed a global consulting services company and has been an executive with a Fortune 100 company. Mr. Barron is responsible for CPS' IT department which include enterprise applications, e-commerce, communications, program management, IT infrastructure, and information security.

Service Area

The CPS electric system serves a territory consisting of substantially all of Bexar County and small portions of the adjacent counties of Comal, Guadalupe, Atascosa, Medina, Bandera, Wilson and Kendall. Certification of this service area has been approved by the PUCT.

CPS is currently the exclusive provider of electric service within this service area, including the provision of electric service to some Federal military installations located within the service area that own their own distribution facilities. As discussed below under "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7", until and unless the San Antonio City Council and the Board exercise the option to opt-in to retail electric competition (called "Texas Electric Choice" by the PUCT), CPS has the sole right to provide retail electric services in its service area. On April 26, 2001, after a thorough feasibility study was conducted and reviewed, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002, the date Texas Electric Choice became effective. Senate Bill 7 ("SB 7"), adopted by the Texas Legislature in 1999, provides that electric "opt-in" decisions are to be made by the governing body or the body vested with the power to manage and operate a municipal utility such as CPS. Given the relationship of the Board and the City Council, any decision to opt-in to electric competition would be based upon the adoption of resolutions of both the Board and the City Council. If the City and CPS choose to opt-in, other retail electric energy suppliers would be authorized to offer retail electric energy in the CPS service area and CPS would be authorized to offer retail electric energy in any other service areas open to retail competition in ERCOT. ERCOT is the independent entity that monitors and administers the flow of electricity within the interconnected grid that operates wholly within Texas. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Interconnected System" and "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments". CPS has the option of acting in the role of the "Provider of Last Resort" (hereinafter defined)

for its service area in the event it and the City choose to opt-in. See “CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7” herein.

In addition to the area served at retail rates, CPS sells wholesale electricity to the Floresville Electric Light & Power System, the City of Hondo, and the City of Castroville. These three wholesale supply agreements have remaining terms ranging from less than one to ten years until expiration, although all of the agreements provide for extensions. Discussions are ongoing with all three entities to renew their respective long-term wholesale power agreements. Additionally, CPS has recently entered into several one-year wholesale supply agreements with other various municipalities and cooperatives. CPS will seek additional opportunities to enter into long-term wholesale electric power agreements in the future. The requirements under the existing and any new wholesale agreements would be firm energy obligations of CPS.

The CPS gas system serves the City and its environs, although there is no certificated CPS gas service area. In Texas, no legislative provision or regulatory procedure exists for certification of natural gas service areas. As a result, CPS competes against other gas supplying entities on the periphery of its service area. Pursuant to the authority provided by Section 181.026, Texas Utilities Code, among other applicable laws, the City has executed a license agreement (“License Agreement”) with the City of Grey Forest, Texas (“Licensee”), dated as July 28, 2003, for a term through May 31, 2028. Pursuant to this License Agreement, the City permits the Licensee to provide, construct, operate and maintain certain natural gas lines within the boundaries of the City which it originally established in 1967 and to provide extensions and other improvements thereto upon compliance with the provisions of the License Agreement and upon the payment to the City of a quarterly license fee of 3.0% of the gross revenues received by the Licensee from the sale of natural gas within the Licensed Area (as defined in the License Agreement). Thus, in the Licensed Area, CPS is in direct competition with Grey Forest Utilities as a supplier of natural gas.

CPS also has 20-year Franchise Agreements with 28 incorporated communities in the San Antonio area. These Franchise Agreements permit CPS to operate its facilities in the city’s streets and public ways in exchange for a franchise fee of 3.0% on electric and natural gas revenues earned within their respective municipal boundaries. Of these 28 agreements, 24 expire in 2010; the others expire in 2011, 2017, 2023 and 2024.

Customer Base

Electric ¹			Gas ¹		
	Number	Percent		Number	Percent
Residential	580,208	87%	Residential	293,803	93%
Commercial & Industrial	63,085	10%	Commercial	18,358	6%
All Night Security Lighting	11,070	2%	Industrial & Public	2,624	1%
Street Lighting, Public Authorities & Other Utilities ²	7,768	1%			
Total	662,131	100%	Total	314,785	100%

(1) At January 31, 2007. See “FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY” and “FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE” for information regarding consumption of energy and contribution of revenues to the Systems by the average customer for these categories.

(2) Also includes off-system sales customers.

Retail Service Rates

Under the Texas Public Utility Regulatory Act (“PURA”), significant original jurisdiction over the rates, services, and operations of “electric utilities” is vested in the PUCT. In this context, “electric utility” means an electric investor-owned utility. Since the electric deregulation aspects of SB 7 became effective on January 1, 2002, the PUCT’s jurisdiction over electric investor-owned utility (“IOU”) companies primarily encompasses only the transmission and distribution functions. PURA generally excludes municipally-owned utilities (“Municipal Utilities”), such as CPS, from PUCT jurisdiction, although the PUCT has jurisdiction over electric wholesale transmission rates. See “Transmission Access and Rate Regulation” herein. Under the PURA, a municipal governing body or the body vested with the power to manage and operate a Municipal Utility such as CPS has exclusive jurisdiction to set rates applicable to all services provided by the Municipal Utility with the exception of electric wholesale transmission activities and rates. Unless and until the City Council and Board choose to opt-in to electric retail competition, CPS retail service electric rates are subject to appellate, but not original rate regulatory jurisdiction by the PUCT in areas that CPS serves outside the San Antonio City limits. To date, no such appeal to the PUCT of CPS retail electric rates has ever been filed. CPS is not subject to the annual PUCT

gross receipts fee payable by electric utilities. See "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7" herein.

The Texas Railroad Commission ("TRC") has significant original jurisdiction over the rates, services and operations of all natural gas utilities in the State. Municipal Utilities such as CPS are generally excluded from regulation by the TRC, except in matters related to natural gas safety. CPS retail gas service rates applicable to rate payers outside San Antonio are subject to appellate, but not original rate regulatory jurisdiction, by the TRC in areas that CPS serves outside the City limits. To date, no such appeal to the TRC of CPS retail gas rates has ever been filed. In the absence of a contract for service, the TRC also has jurisdiction to establish gas transportation rates for service to Texas State Agencies by a Municipal Utility. A Municipal Utility is also required to sell gas to and transport State-owned gas for "public retail customers," including State agencies, State institutions of higher education, public school districts, U.S. military installations, and U.S. Veterans Affairs facilities, at rates provided by written contract between the Municipal Utility and the buyer entity. If agreement to such a contract cannot be reached, a rate would be set by the legal and relevant regulatory body.

The City has covenanted and is obligated under the bond ordinances, as provided under the rate covenant, to establish and maintain rates and collect charges in an amount sufficient to pay all maintenance and operating expenses of the Systems and to pay the debt service requirements on all revenue debt of the Systems, including the outstanding Previously Issued Parity Bonds, the Bonds, any Additional Senior Lien Obligations, the currently outstanding Junior Lien Obligations, Liquidity Facility obligations, any Additional Junior Lien Obligations, the Notes and Inferior Lien Obligations, and to make all other payments prescribed in the bond ordinances.

Rate changes over the past 16 years have consisted of a 4.0% combined electric and gas base rate increase effective January 31, 1991; a new Large Volume Gas rate effective July 31, 1992, which was offered to Large Gas Customers whose monthly gas usage exceeded 550 MCF per month and enabled them to reduce bills by approximately 8.8%; a Super Large Power ("SLP") electric rate effective January 4, 1994, which reduced the basic rates to customers having loads greater than 5,000 KW per month and annual load factors greater than 41% by approximately 10.1%; a 3.5% electric base rate adjustment effective May 19, 2005, and a 12.1% gas base rate adjustment effective June 26, 2006. The 2005 electric rate adjustment was intended to offset the incremental costs to be incurred due to acquiring an additional 12.0% share in the STP. This acquisition was completed in May 2005. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - South Texas Project" herein. CPS projects that the net effect of the base rate adjustment and fuel cost savings from additional nuclear-fueled generation will result in lower overall bills for CPS' electric customers. CPS also offers a monthly contract for renewable energy service (currently this is wind-generated electricity) under Rider E15, which became effective May 2000. The rate for Rider E15 was reduced to its current level effective on September 30, 2002. A rider to the SLP rate, the Economic Incentive Rider E16, became effective March 10, 2003, and offers discounts off the SLP demand charge for a period up to four years for new or added load of at least 10 megawatts ("MW"). Under certain conditions, the discount may be extended an additional three years. Customers that choose Economic Incentive Rider E16 must also meet City employment targets and targets for purchases of goods or services from local businesses in order to qualify. CPS also has rates that permit recovery of certain miscellaneous customer charges and for extending lines to provide gas and electric service to its customers. In May 2005, the Board adopted a change to its policies for both miscellaneous customer charges and line extensions, which became effective January 1, 2006, to increase charges that had not been raised since 1986. On December 15, 2005, the City Council adopted Ordinance Nos. 101819 and 101820 approving certain of the price changes in the CPS Board-approved policy; however, the City ordinances prevent recovery of increased line extension charges from developers of affordable housing and the City delayed implementation of certain miscellaneous customer charges until April 1, 2006 (fees for disconnection, reconnection and field notification).

Each of CPS' retail and wholesale rates contains an electric fuel adjustment or gas cost adjustment clause, which provides for current recovery of fuel costs. The fuel cost recovery adjustments are set at the beginning of each CPS monthly billing cycle month. See "CUSTOMER RATES – Fuel and Gas Cost Adjustment" herein.

Transmission Access and Rate Regulation

Pursuant to amendments made by the Texas Legislature in 1995 to the PURA ("PURA95"), Municipal Utilities, including CPS, became subject to the regulatory jurisdiction of the PUCT for transmission of wholesale energy. PURA95 requires the PUCT to establish open access transmission on the interconnected Texas grid for all utilities, co-generators, power marketers, independent power producers and other transmission customers.

The 1999 Texas Legislature amended the PURA95 to expressly authorize rate authority over Municipal Utilities for wholesale transmission and to require that the postage stamp method be used exclusively for pricing wholesale transmission transactions. The PUCT in late 1999 amended its transmission rule to incorporate fully the postage stamp pricing method which sets the price for transmission at the system average for ERCOT. CPS' wholesale open access

transmission charges are set out in tariffs filed at the PUCT, and are based on its transmission cost of service approved by the PUCT, representing CPS' input to the calculation of the statewide postage stamp pricing method. The PUCT's rule, consistent with provisions in PURA §35.005(b), also provides that the PUCT may require construction or enlargement of transmission facilities in order to facilitate wholesale transmission service. Pursuant to P.U.C. Docket No. 31540, "Proceeding to Consider Protocols to Implement a Nodal Market in the Electric Reliability Council of Texas Pursuant SUBST. R. 25.501", the PUCT has made substantial progress in evaluating the shift from postage stamp pricing to nodal pricing for transmission transactions. Until the PUCT takes final action on nodal pricing, it will not be possible to predict the effects on CPS' transmission costs or its ability to recover costs from other participants in ERCOT. Additional information on recovery of ERCOT transmission fees is discussed in "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments" and with respect to the transition to the nodal market which is discussed in "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Post Senate Bill 7 Wholesale Market Design Developments" herein.

CUSTOMER RATES

CPS' electric and gas monthly rate schedules list the currently effective monthly charges payable by CPS customers. Each rate schedule briefly describes the types of service CPS renders to customers billed in accordance with that rate schedule, plus customer eligibility criteria. Customers with similar load and usage characteristics are grouped into rate classes and are billed in accordance with the same rate schedule. The different electric rate classes include rate schedules for residential, commercial, and industrial customers. There are also rate schedules for street lighting, other utilities and all night security lights. The gas rate schedules are categorized into general, commercial and industrial.

Fuel and Gas Cost Adjustment

The rates feature a fuel cost adjustment provision in the electric rates and a gas adjustment provision in the gas rates which allow CPS to reconcile fuel and gas cost variances above or below base fuel levels included in base rates. CPS' electric rates are subject to a positive or negative adjustment equal to the variance in the price of fuel above or below a base cost of \$0.01416 per kWh. Similarly, CPS' base gas rates are subject to an adjustment equal to the variance in the price of fuel above or below a base cost of \$0.220 per CCF (100 cubic feet).

Governmentally Imposed Fees, Taxes or Payments

The rates, as previously approved by various rate ordinances adopted by the City Council, may be adjusted without further action by the City Council to reflect the increase or decrease of fees, taxes or other required payments to governmental entities or for governmental or municipal purposes which may be hereafter assessed, imposed, or otherwise required and which are payable out of or are based upon Net Revenues of the Systems.

In March 2000, two new governmental assessments resulting from regulatory changes in the Texas electric utility industry, including the open access wholesale transmission charges, were added to CPS' electric billings as regulatory adjustments and will be updated annually or as needed. The first assessment recovers additional ERCOT-related transmission expenditures not recovered through CPS' current base rates. For residential CPS customer rates, this adjustment (effective September 2006) currently adds an additional \$0.00154 per kWh sold. The second assessment relates to CPS' share of the cost to fund the staffing and operation of the Independent System Operator ("ISO") for ERCOT, the implementation of the nodal market within ERCOT, as well as other market-related costs due to congestion and voltage reliability issues. The PUCT retains oversight authority over ERCOT. For residential CPS customers, this charge increases bills by an additional \$0.00059 per kWh sold.

In March 2005, the Texas Railroad Commission began imposing a regulatory fee to cover the cost of regulation by the Texas Railroad Commission. The fee is based upon the number of active gas customers and is recovered from CPS gas customers through the payment of a one time annual fee.

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TEN-YEAR ELECTRIC CUSTOMER STATISTICS¹

	Fiscal Year Ended January 31,									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
RESIDENTIAL										
Average Monthly KWH/ Customer	1,059	1,140	1,104	1,190	1,141	1,154	1,174	1,159	1,217	1,247
Average Monthly Bill/ Customer	\$69.49	\$74.37	\$72.84	\$85.55	\$77.53	\$81.54	\$94.06	\$87.39	\$99.59	\$98.27
Average Monthly Revenue/KWH	\$0.0656	\$0.0652	\$0.0660	\$0.0719	\$0.0679	\$0.0707	\$0.0801	\$0.0754	\$0.0818	\$0.0788
COMMERCIAL AND INDUSTRIAL										
Average Monthly KWH/ Customer	10,603	10,966	10,874	11,145	11,116	11,334	12,174	11,345	11,187	11,036
Average Monthly Bill/ Customer	\$539.73	\$550.73	\$554.06	\$629.98	\$594.33	\$631.54	\$790.31	\$691.48	\$754.65	\$710.85
Average Monthly Revenue/KWH	\$0.0509	\$0.0502	\$0.0510	\$0.0565	\$0.0535	\$0.0557	\$0.0649	\$0.0609	\$0.0675	\$0.0644
ALL CUSTOMERS										
Average Monthly KWH/ Customer	2,303	2,425	2,383	2,475	2,404	2,434	2,440	2,401	2,471	2,499
Average Monthly Bill/ Customer	\$129.42	\$135.12	\$134.50	\$154.65	\$142.08	\$151.31	\$173.82	\$159.88	\$180.27	\$174.92
Average Monthly Revenue/KWH	\$0.0562	\$0.0557	\$0.0564	\$0.0625	\$0.0591	\$0.0622	\$0.0712	\$0.0666	\$0.0730	\$0.0700

(1) Excludes unbilled revenues.

HISTORICAL RECORD OF CITY OF SAN ANTONIO GENERAL FUND BENEFITS FROM CITY'S ELECTRIC AND GAS UTILITY SYSTEMS (Dollars in Thousands)

	Fiscal Years Ended January 31,									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Payments To City ¹	\$ 138,543	\$ 144,555	\$ 145,474	\$ 185,006	\$ 168,135	\$ 172,235	\$ 206,057	\$ 194,901	\$ 227,178	\$ 235,898

(1) Payments to the City, by ordinance, are not to exceed 14% of CPS' gross revenue, include cash payments and refund of charges for furnishing the City electricity and gas services, and for a street light replacement program.

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FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY

	Fiscal Year Ended January 31,				
	2003	2004	2005	2006	2007
ELECTRIC SYSTEM					
SALES IN KWH¹					
Residential	7,248,869,894	7,380,490,515	7,449,673,383	8,052,142,783	8,546,981,548
Commercial & industrial	7,732,905,220	8,485,624,162	8,024,602,819	8,074,456,666	8,264,544,798
Street lighting	77,694,161	79,634,339	79,423,113	81,014,821	91,350,091
Public authorities	1,829,765,716	1,100,521,486	1,633,005,953	1,965,844,597	2,218,197,824
Other utilities	502,552,040	1,195,537,532	1,622,928,313	1,849,949,855	2,958,437,090
ANSL ²	19,358,876	19,822,990	20,137,010	20,850,505	21,199,115
Total sales in KWH	<u>17,411,145,907</u>	<u>18,261,631,024</u>	<u>18,829,770,591</u>	<u>20,044,259,227</u>	<u>22,100,710,466</u>
AVERAGE NUMBER OF CUSTOMERS					
Residential	523,424	524,108	535,784	551,355	571,148
Commercial & industrial	56,855	58,086	58,943	60,145	62,407
Street lighting	115	147	198	422	2,320
Public authorities	5,375	5,442	6,471	6,293	5,628
Other utilities	13	14	19	20	18
ANSL ²	10,239	10,303	10,445	10,725	10,953
Total customers	<u>596,021</u>	<u>598,100</u>	<u>611,860</u>	<u>628,960</u>	<u>652,474</u>
KWH SALES PER CUSTOMER					
Residential	13,849	14,082	13,904	14,604	14,964
Commercial & industrial	136,011	146,087	136,142	134,250	132,430
GAS SYSTEM					
SALES IN MCF¹					
Residential	12,088,082	11,215,488	10,607,280	9,794,730	9,474,163
Commercial	8,888,993	8,872,513	8,595,134	8,420,965	8,719,182
Industrial	1,494,910	1,278,389	1,175,241	1,184,875	1,095,727
Public authorities	1,785,520	1,800,675	2,026,390	2,258,826	2,081,997
Total sales in MCF	<u>24,257,505</u>	<u>23,167,065</u>	<u>22,404,045</u>	<u>21,659,396</u>	<u>21,371,069</u>
AVERAGE NUMBER OF CUSTOMERS					
Residential	286,006	285,241	287,096	288,898	292,083
Commercial	18,536	18,795	18,758	18,411	18,237
Industrial	99	93	87	80	76
Public authorities	2,079	2,216	2,334	2,373	2,540
Total customers	<u>306,720</u>	<u>306,345</u>	<u>308,275</u>	<u>309,762</u>	<u>312,936</u>
MCF SALES PER CUSTOMER					
Residential	42	39	37	34	32
Commercial	480	472	458	457	478
Industrial	15,100	13,746	13,509	14,811	14,417

(1) Excludes unbilled revenues and sales.

(2) All Night Security Lighting.

FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE¹

	Fiscal Year Ended January 31,				
	2003	2004	2005	2006	2007
ELECTRIC SYSTEM					
BILLED REVENUES					
Residential	\$512,164,406	\$591,592,883	\$561,876,727	\$658,916,783	\$673,553,856
Commercial & industrial	430,872,999	550,872,351	489,091,773	544,660,000	532,343,750
Street lighting	8,431,030	11,007,177	10,724,868	11,414,666	11,314,041
Public authorities	95,842,688	70,965,854	89,671,069	117,661,362	127,237,302
Other utilities	30,209,384	47,755,523	67,096,105	107,656,944	145,115,015
ANSL ²	4,659,021	3,029,184	2,810,373	3,298,367	3,254,248
Other	9,900,798	14,932,968	23,660,332	15,951,021	13,751,476
Total revenues	<u>1,092,080,326</u>	<u>1,290,155,940</u>	<u>1,244,931,247</u>	<u>1,459,559,143</u>	<u>1,506,569,688</u>
OPERATION & MAINTENANCE EXPENSE					
Production	312,328,375	436,648,229	392,918,275	499,098,803	531,000,491
Transmission	9,298,516	10,981,566	11,828,869	12,029,652	16,441,817
Distribution	50,798,655	53,739,899	62,775,897	61,000,014	74,886,837
Regulatory assessments	22,294,418	45,850,991	42,075,814	37,083,246	28,644,959
Customer accounts	13,187,147	13,542,047	15,550,798	18,673,088	22,523,086
Customer information	1,662,252	1,308,208	976,222	1,436,331	791,074
Administrative & general	102,486,169	97,414,525	80,498,588	77,595,068	58,947,387
Payroll taxes	8,638,622	8,448,062	8,138,567	7,496,083	4,651,131
STP decommissioning expense	15,189,000	15,189,000	6,328,750	4,380,000	4,380,000
STP operating & maintenance expense	82,727,552	96,446,032	96,014,075	131,601,697	149,100,712
Total expenses	<u>618,610,706</u>	<u>779,568,559</u>	<u>717,105,855</u>	<u>850,393,982</u>	<u>891,367,494</u>
Operating income - electric	<u>473,469,620</u>	<u>510,587,381</u>	<u>527,825,392</u>	<u>609,165,161</u>	<u>615,202,194</u>
GAS SYSTEM					
BILLED REVENUES					
Residential	84,616,216	112,683,034	105,158,123	119,685,785	120,927,007
Commercial & industrial	55,476,154	82,988,207	79,393,303	102,757,554	99,297,749
Public authorities	9,122,495	13,978,202	15,521,605	21,707,539	19,766,696
Other	1,813,411	1,204,893	1,264,134	1,153,715	1,144,716
Total revenues	<u>151,028,276</u>	<u>210,854,336</u>	<u>201,337,165</u>	<u>245,304,593</u>	<u>241,136,168</u>
OPERATION & MAINTENANCE EXPENSE					
Gas purchased	90,955,067	131,631,165	133,966,032	170,893,663	174,793,863
Distribution	12,071,625	13,483,883	14,179,683	16,648,494	18,694,494
Customer accounts	6,480,485	6,654,891	7,659,348	9,197,192	11,093,460
Customer information	557,340	438,632	325,407	478,777	263,691
Administrative & general	9,912,117	9,427,835	8,055,949	8,302,787	6,219,420
Payroll taxes	1,573,754	1,265,704	1,216,108	1,120,105	694,997
Total expenses	<u>121,550,388</u>	<u>162,902,110</u>	<u>165,402,527</u>	<u>206,641,018</u>	<u>211,759,925</u>
Operating income - gas	<u>29,477,888</u>	<u>47,952,226</u>	<u>35,934,638</u>	<u>38,663,575</u>	<u>29,376,243</u>
Combined operating income- Electric and gas	502,947,508	558,539,607	563,760,030	647,828,736	644,578,437
Nonoperating income	28,547,471	25,893,513	26,986,005	50,063,264	74,524,014
NET REVENUES, per ordinances	<u>\$531,494,979</u>	<u>\$584,433,120</u>	<u>\$590,746,035</u>	<u>\$697,892,000</u>	<u>\$719,102,451</u>
DEBT SERVICE					
Senior lien obligations - Principal and interest	\$211,830,818	\$230,249,667	\$245,984,372	\$256,442,059	\$271,931,037
Junior lien obligations - interest	0	2,111,053	4,386,011	10,964,118	15,005,843
Interest on commercial paper	5,327,359	4,125,319	5,125,135	7,693,133	8,503,062
TOTAL DEBT SERVICE	<u>\$217,158,177</u>	<u>\$236,486,039</u>	<u>\$255,495,518</u>	<u>\$275,099,311</u>	<u>\$295,439,942</u>
DEBT SERVICE COVERAGE					
Senior & junior lien obligations and commercial paper	2.45x	2.47x	2.31x	2.54x	2.43x
Senior lien obligations	2.51x	2.54x	2.40x	2.72x	2.64x

(1) Excludes component units.

(2) All Night Security Lighting.

FORWARD-LOOKING STATEMENTS

This Official Statement, including the Appendices hereto, contains forward-looking statements within the meaning of the federal securities laws. Such statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the power utility industry and general economic conditions. Such words as expects, intends, plans, believes, estimates, anticipates or variations of such words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. Actual results may vary materially from what is contained in a forward-looking statement. Factors which may cause a result different from those expected or anticipated include, among other things, new legislation, increases in suppliers' prices, particularly prices for fuel in connection with the operation of the Systems, changes in environmental compliance requirements, acquisitions, changes in customer power use patterns, natural disasters and the impact of weather on operating results.

Although CPS believes in making any such forward-looking statement, its expectations are based on reasonable assumptions, any such forward-looking statement involves uncertainties and is qualified in its entirety by reference to factors both identified within this Official Statement and from publicly available resources about the electric and gas businesses, regulation and regulatory authorities for that business, and the City that could cause the actual results of CPS to differ materially from those contemplated in such forward-looking statements.

Any forward-looking statement speaks only as of the date on which such statement is made, and CPS undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for CPS to predict all of such factors, nor can it assess the impact of each such factor or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

MANAGEMENT DISCUSSION

CPS' audited financial statements for the fiscal years ended January 31, 2007 and 2006, and the Independent Auditors' report thereon are in APPENDIX B. As described herein, CPS adopted Statement No. 34 of the Governmental Accounting Standards Board ("GASB") during its fiscal year ended January 31, 2002, which required the preparation of a Management Discussion and Analysis ("MD&A") in connection with the annual financial report of CPS. Reference is hereby made to APPENDIX B for the MD&A pertaining to the CPS fiscal year ended January 31, 2007.

The operating results of the Systems reflect the results of past operations and are not necessarily indicative of results of operations for any future period. Future operations will be affected by factors relating to changes in rates, fuel and other operating costs, utility industry regulation and deregulation, environmental regulation, economic growth of the community, population, weather, and other matters; the nature and effect of which cannot at present be determined. See "FORWARD-LOOKING STATEMENTS" herein.

IMPLEMENTATION OF NEW ACCOUNTING POLICIES

For the fiscal year ended January 31, 2007, CPS implemented:

- GASB Statement No. 43, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*. The statement establishes uniform standards of financial reporting for other Post-Employment benefit plans. The statement establishes disclosure requirements for both the employee benefit plans and employer financial statements. Disclosure requirements for the employer have been incorporated into Appendix B, Note 9 – Employee and Other Post-Employment Benefits.
- GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Provisions of Medicare Part D*. The technical bulletin clarifies the application of existing standards of accounting and financial reporting to payments received by an employer or its OPEB plan from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. Disclosure requirements for the employer have been incorporated into Appendix B, Note 9 – Employee and Other Post-Employment Benefits.

Other than the aforementioned changes, there were no additional significant accounting principles or reporting changes implemented in the fiscal year ending January 31, 2007.

Other accounting and reporting changes that occurred during the prior reporting year continued into the fiscal year ending January 31, 2007.

These accounting changes and the effects on the financial statements are described in greater detail in the MD&A and in the notes to the audited financial statements included in APPENDIX B.

PENSION, EMPLOYEE, AND OTHER POST-EMPLOYMENT BENEFITS

CPS provides Pension and Other Post-Employment Benefits ("OPEBs") for its employees. The CPS plans consist of four plans: the Pension Plan, the Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan. All plans are reported on a calendar year basis. See "Notes to Basic Financial Statements – Note 8 – Employee Pension Plan and Note 9 – Employee and Other Post-Employment Benefits" in Appendix B ("Notes 8 & 9").

Pension Plan

The Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan and provides retirement and ancillary benefits for all CPS employees who complete a minimum period of service and/or otherwise become eligible. The benefits provided by the Pension Plan are paid from a Pension Trust Fund established by CPS that is kept separate from and in addition to the benefits employees are entitled to receive under any other CPS program and under the federal Social Security Act. This Pension Plan and the Pension Trust Fund were established by the Board in accordance with applicable law and are maintained for the exclusive benefit of the eligible employees and their beneficiaries.

Employee Benefit Plans

The Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan ("Employee Benefit Plans") are reported as a component unit on CPS' Balance Sheets. See "Appendix B – City Public Service – Audited Financial Statements for the Fiscal Years Ended January 31, 2007 and 2006" herein and the related footnote disclosures. These Employee Benefit Plans are funded by employee contributions and annual contributions from CPS as determined by the Board in accordance with applicable law. The assets of the Employee Benefit Plans are stated at fair market value. Consistent with the requirements of GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" (Issued November 2004), the Pension Plan is not shown as a component unit on CPS' Balance Sheets.

The Group Health Plan and the Group Life Insurance Plan provide benefits for employees, their spouses, and covered dependents. Additionally, most CPS employees are also eligible for these benefits upon retirement. CPS established each plan as a "risk pool" as that term is defined in the Texas Political Subdivision Employees Uniform Group Benefits Act ("Act"), Chapter 172 Texas Local Government Code. These plans are each operated at all times and in all respects as a risk pool under the Act. CPS' Disability Income Plan, also established as a risk pool, provides income to eligible employees of CPS who become disabled.

PENSION AND OPEB LIABILITIES

Actuarial Value of Plan Assets

CPS annually retains an actuarial firm to perform actuarial valuations for the Pension Plan and each of the Employee Benefit Plans. Conducted in accordance with generally accepted actuarial principles and practices, the actuarial reports summarize the funding status of each plan for the prior two calendar years ending December 31st. The reports also provide projected funding contribution requirements CPS' next fiscal year. The Actuarial Value of the assets of each of the plans represents an adjusted value determined by the actuary, in accordance with industry standards, and therefore will not equal the amounts shown in the CPS Balance Sheets.

Actuarial Accrued Liability

The Actuarial Accrued Liability ("AAL") is calculated on a present value basis. Significant actuarial assumptions used in the calculations include, but are not limited to, rates of mortality, rates of retirement, the estimated number of participants expected to withdraw from the program(s), expected base salary increases, overtime rates, disability rates, medical cost increases, and investment returns. The AAL includes liabilities for current retirees, active employees that are fully eligible and for active employees that are not fully eligible.

Use of Assumptions and Estimates

As set forth herein and in Notes 8 & 9 of Appendix B, the disclosure relating to the Pension Plan and the Employee Benefit Plans are based upon certain assumptions and estimates that may vary based upon the risk factors disclosed herein and in Notes 8 & 9 of Appendix B and to the extent that these assumptions and estimates do not materialize or are inaccurate, the financial information disclosed herein and in Notes 8 & 9 of Appendix B, including the estimated as compared to the actual values of the assets and liabilities, could change substantially and in a materially adverse manner. The actuarial values determined for benefit plan assets and liabilities include reasonable assumptions which are estimates based on information available at the time the study was conducted. The Group Health Plan AAL, as reported below, excludes any offset in costs resulting from the government subsidizing voluntary prescription drug benefits under a new section "Part D" of the Social Security Act, established as part of the Medicare Prescription Drug Improvement and Modernization Act of 2003. The Part-D subsidy pertains to benefits beginning January 1, 2006. On June 30, 2006, GASB issued a Technical Bulletin regarding the Medicare Part-D subsidy. The Technical Bulletin clarified that the Medicare Part-D subsidy should be excluded when reporting the AAL.

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Pension and Employee Benefit/OPEB Funding

The schedule below outlines CPS' Pension and OPEB funding status based on January 1, 2007, 2006, and 2005 Actuarial Valuations. Although CPS is not contractually required to make contributions to fund the future liabilities of the Employee Benefit Plans, it has been voluntarily doing so since 1992.

PENSION AND EMPLOYEE BENEFIT PLANS

(\$ in millions)

	(A) Actuarial Value of Plan Assets			(B) Actuarial Accrued Liability ("AAL")¹		
	January 1			January 1		
	2007	2006	2005	2007 ³	2006	2005
Pension	\$ 1,012.1	\$ 955.3	\$ 902.1	\$ 1,042.0	\$ 906.4	\$ 837.6
OPEBs:						
Group Health	\$ 150.8	\$ 133.9	\$ 121.7	\$ 220.7	\$ 228.4	\$ 233.3
Group Life	49.1	46.7	44.2	45.5	60.9	58.0
Disability ²	3.9	4.1	4.2	5.2	6.0	3.6
Total OPEBs	\$ 203.8	\$ 184.7	\$ 170.1	\$ 271.4	\$ 295.3	\$ 294.9

	(B) - (A) Unfunded AAL			(A) / (B) Funded Ratio		
	January 1			January 1		
	2007	2006	2005	2007	2006	2005
Pension	\$ 29.9	\$ (48.9)	\$ (64.5)	97.1%	105.4%	107.7%
OPEBs:						
Group Health	\$ 69.9	\$ 94.5	\$ 111.6	68.3%	58.6%	52.2%
Group Life	(3.6)	14.2	13.8	107.9%	76.6%	76.2%
Disability ²	1.3	1.9	(0.6)	75.0%	68.3%	116.7%
Total OPEBs	\$ 67.6	\$ 110.6	\$ 124.8	75.1%	62.5%	57.7%

(1) Includes liabilities for retirees, fully eligible actives, and actives not yet fully eligible. The Group Health Plan does not reflect Medicare Part D Subsidy of approximately \$38.8 million for 2007 and \$36.4 million for 2006.

(2) Disability AAL for January 1, 2005 is not presented in accordance with GASB Statement 43.

(3) The actuarial assumptions related to the Pension have been changed since the prior valuation as a result of an experience study and an actuarial assumption review covering the 2001-2006 actuarial valuation data. The changes in actuarial assumptions increased the AAL as of January 1, 2007 by \$77.7 million.

CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY

The Electric Utility Industry Generally

The electric utility industry in general has been, and in the future may be, affected by a number of factors which could impact upon the business affairs, financial condition and competitiveness of an electric utility and the level of utilization of generating facilities, such as those of the Systems. One of the most significant of these factors is the effort on national and local levels to restructure the electric utility industry from a heavily regulated monopoly to an industry in which there is open competition for power supply on both the wholesale and retail level. (For a description of the competition in the electric utility industry in Texas and the response of the Systems thereto, see "Electric Utility Restructuring in Texas; Senate Bill 7" herein.)

In addition, such factors include, among others, (i) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (ii) changes resulting from conservation and demand-side management

programs on the timing and use of electric energy, (iii) changes that might result from a national energy policy, (iv) increased competition from independent power producers, (v) "self-generation" by certain industrial and commercial customers, (vi) issues relating to the ability to issue tax-exempt obligations, (vii) severe restrictions on the ability to sell to non-governmental entities electricity from generation projects financed with outstanding tax-exempt obligations, (viii) changes from projected future electricity requirements, (ix) increases in costs, (x) shifts in the availability and relative costs of different fuels and, (xi) effects of the financial difficulties confronting the power marketers. Any of these factors (as well as other factors) could have an effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways. CPS cannot predict what future effects these factors may or will have on its business operations and financial condition, but the effects could be significant. The following is a brief discussion of certain of these factors. However, this discussion does not purport to be comprehensive or definitive and these matters are subject to change subsequent to the date of this Official Statement. Extensive information on the electric utility industry is available from sources in the public domain, and potential purchasers of the Bonds should obtain and review such information.

Federal Energy Legislation

In August 2005, the Energy Policy Act of 2005 ("2005 Energy Act"), passed the House and Senate and was signed by the President. There are provisions in this new law that may affect CPS including the extension of limited Federal Energy Regulatory Commission ("FERC") jurisdiction, known as "FERC-Lite", over public power entities such as CPS that own transmission lines, and which give FERC authority to delegate certain transmission reliability standard-setting responsibilities to an Electric Reliability Organization ("ERO") and, with the ERO, establish mandatory reliability standards for operation of the nation's transmission system, even within ERCOT. CPS has operated its electric system under compatible ERCOT reliability standards for many years, so CPS does not anticipate any problems with FERC's reliability standards; however, CPS will not know the impact of FERC-Lite until such time as FERC issues implementing rules that make clear those requirements. Additional information on FERC's authority over CPS can be found in "FERC Authority" herein.

The 2005 Energy Act has additional provisions that could affect CPS' business, which are currently under evaluation by CPS, including:

- repeal of existing Public Utility Holding Company Act of 1935 requirements;
- provision for state and large non-regulated utility consideration of five new Federal Standards - including time-based metering and communications, net metering, fuel generation source diversification, increased efficiency in fossil-fuel generation, and interconnections of on-site consumer generation facilities with utility distribution systems. [Note: municipal utilities such as CPS are designated as "non-regulated" under the 2005 Energy Act because those utilities are not regulated by state utility commissions.];
- conditional termination of the mandatory federal purchase and sale requirements for cogeneration and small power production;
- expansion of FERC's merger review authority;
- reauthorization of renewable energy production incentives for solar, wind, geothermal, and biomass and authorization of new incentives for landfill gas;
- establishment of a 7.5 percent goal for increased renewable energy use by the federal government by 2013, and of a 20.0 percent required reduction in energy use by federal buildings by 2015; and
- increased funding for low-income weatherization and for state energy efficiency programs.

The 2005 Energy Act also has provisions affecting existing nuclear generating units, including:

- extension of the Price-Anderson Act to 2025 and increases in the retrospective premiums for which licensees are liable for claims resulting from a nuclear incident;
- expansion of the Nuclear Regulatory Commission ("NRC") authority to regulate decommissioning trust funds (primarily affecting funds held by former plant licensees);
- direction of the U.S. Department of Energy ("DOE") to take responsibility for safe disposal of high-level radioactive waste;
- procedural protections for individuals filing claims under federal whistleblower provisions;
- enhanced provisions relating to NRC oversight of the security of licensed facilities; and
- various decommissioning tax-related adjustments beneficial to federal tax-paying licensees.

The 2005 Energy Act will affect CPS indirectly. CPS will be required to hold public hearings on and to consider the five new Federal Standards established under the 2005 Energy Act. The indirect impacts of the 2005 Energy Act on CPS cannot be predicted at this time.

FERC Authority

In 1992, pursuant to the Energy Policy Act of 1992 ("Energy Act"), the FERC required utilities under FERC jurisdiction to provide access to their electric transmission systems for interstate wholesale transactions on terms and at rates comparable to those available to the owning utility for its own use. Municipal Utilities like CPS are subject to FERC orders requiring provision of wholesale transmission service to other utilities, qualifying cogeneration facilities and independent power producers. Under FERC rules promulgated subsequent to the Energy Act, FERC further expanded open access wholesale transmission by requiring public utilities operating in interstate commerce to file open access non-discriminatory transmission tariffs. Because the interconnected ERCOT grid operates outside interstate commerce and because PURA95 and SB 7, Texas State laws discussed below, provide comparable wholesale transmission authority to the PUCT for utilities in ERCOT pursuant to which the PUCT has required open access of transmission facilities in ERCOT, the exercise of FERC authority relating to open access transmission has not been a major factor in the operation of the wholesale market in ERCOT. The 2005 Energy Act authorizes FERC to encourage and approve the voluntary formation of regional transmission organizations in order to promote fair and open access to electric transmission service and facilitate wholesale competition. See "Federal Energy Legislation" herein. The ERCOT open access system is administered by an ISO conducting many of the functions that would be administered by a Regional Transmission Organization. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Interconnected System" herein.

Electric Utility Restructuring in Texas; Senate Bill 7

During the 1999 legislative session, the Texas Legislature enacted SB 7, providing for retail electric open competition. This began on January 1, 2002. SB 7 continues Texas electric transmission wholesale open access, which came into effect in 1997 and requires all transmission system owners to make their transmission systems available for use by others at prices and on terms comparable to each respective owner's use of its system for its own wholesale transactions. SB 7 also fundamentally redefines and restructures the Texas electric industry. The following discussion of SB 7 applies primarily to ERCOT.

SB 7 includes provisions that apply directly to Municipal Utilities such as CPS, as well as other provisions that govern IOUs and electric co-operatives ("Electric Co-ops"). As of January 1, 2002, SB 7 allows retail customers of IOUs to choose their electric energy suppliers. SB 7 also allows retail customers of those Municipal Utilities and Electric Co-ops that elect, on or after that date, to participate in retail electric competition. Provisions of SB 7 that apply to the CPS electric system, as well as provisions that apply only to IOUs and Electric Co-ops are described below, the latter for the purpose of providing information concerning the overall restructured electric utility market in which CPS and the City could choose to directly participate in the future.

SB 7 required IOUs to separate their retail energy service activities from regulated utility activities by September 1, 2000 and to unbundle their generation, transmission/distribution and retail electric sales functions into separate units by January 1, 2002. An IOU may choose to sell one or more of its lines of business to independent entities, or it may create separate but affiliated companies and possibly operating divisions. If so, these new entities may be owned by a common holding company, but each must operate largely independent of the others. The services offered by such separate entities must be available to other parties on non-discriminatory bases. Municipal Utilities and Electric Co-ops which open their service territories ("opt-in") to retail electric competition are not required to, but may, unbundle their electric system components. See "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Service Area" herein.

Entities that have Opted-in to Competition

The following discussion relates to entities that are currently in electric competition in Texas, and does not apply to CPS, but could apply if CPS and the City opt-in to electric competition. Generation assets of IOUs are owned by "Power Generation Companies", which must register with the PUCT and must comply with certain rules that are intended to protect consumers, but they otherwise are unregulated and may sell electricity at market prices. IOU owners of transmission and/or distribution facilities are "Transmission and Distribution Utilities" and are fully regulated by the PUCT. Retail sales activities are performed by "Retail Electric Providers" ("REPs") which are the only entities authorized to sell electricity to retail customers (other than Municipal Utilities and Electric Co-ops within their service areas, or, if they have adopted retail competition, also outside their service areas). REPs must register with the PUCT, demonstrate financial capabilities and comply with certain consumer protection requirements. REPs buy electricity from Power Generation Companies, power marketers, and/or other parties and may resell that electricity to retail customers at any location in Texas (other than within service areas of Municipal Utilities and Electric Co-ops that have not opened their service areas to retail competition). Transmission and Distribution Utilities and Municipal Utilities and Electric Co-ops

that have chosen to participate in competition are obligated to deliver electricity to retail customers and are all also required to transport electricity to wholesale buyers. The PUCT is required to approve the construction of new Transmission and Distribution Utilities' transmission facilities outside the electric system's service territory and may order the construction of new facilities in Texas in order to relieve transmission congestion. Transmission and Distribution Utilities are required to provide access to both their transmission and distribution systems on a non-discriminatory basis to all eligible customers. Retail rates for the use of distribution systems of Municipal Utilities and Electric Co-ops are exclusively within the jurisdiction of these entities' governing bodies rather than that of the PUCT.

SB 7 also provides a number of consumer protection provisions. Each service area within Texas that participates in retail competition has a designated "Provider of Last Resort"; those Providers of Last Resort serving in former service areas of IOUs are selected and approved by the PUCT. The Provider of Last Resort is an REP that must offer to sell electricity to any retail customer in its designated area at a standard rate approved by the PUCT. The Provider of Last Resort must also serve any customer whose REP has failed to provide service. Each Municipal Utility and Electric Co-op that opts-in to retail competition may designate itself or another qualified entity as the Provider of Last Resort for its service territory. In such cases, the respective Municipal Utility or Electric Co-op, not the PUCT will set the electric rates for such respective Provider of Last Resort.

Beginning September 1, 1999, each IOU was required to freeze its then existing rates (except for a fuel factor pass through) and was required to continue to serve its retail customers at such rates until 2002. Beginning January 1, 2002, the unbundled REP of the IOU that held the certificate to provide retail service to an area ("Affiliated REP") was required to reduce electric rates by 6% below the frozen rates and offer that reduced rate ("price to beat") to all residential and small commercial retail customers in the area formerly served by the IOU. The Affiliated REP was not allowed to sell electricity to residential or small commercial customers at any other rate until the earlier of either 40% of the residential or small commercial customers in the area had chosen to be served by other REPs or until January 1, 2005. SB 7 does allow Affiliated REPs to compete for industrial customers and for certain aggregated commercial loads owned by a common entity. The price to beat provisions of SB 7 currently has no direct impact on CPS.

Under SB 7, IOUs may recover a portion of their "stranded costs" (the net book value of certain "non-economic" assets less market value and certain "above market" purchased-power costs) and "regulatory assets", which is intended to permit recovery of the difference between the amount necessary to pay for the assets required under prior electric regulation and the amount that can be collected through market-based rates in the open competition market. SB 7 establishes the procedure to determine the amount of IOU stranded costs and regulatory assets. The PUCT has determined the stranded costs, which have been and will be collected through a non-bypassable competitive transition charge collected from the end retail electric users within the IOU's service territory as it existed on May 1, 1999. The charge is collected primarily as an additional component to the rate for the use of the retail electric distribution system delivering electricity to such end user.

IOUs may recover a certain portion of their respective stranded costs through the issuance of bonds, with a maturity not to exceed 15 years, whereby the principal, interest and reasonable costs of issuing, servicing and refinancing such bonds is secured by a qualified rate order of the PUCT that creates the "competitive transition charge". Neither the State of Texas nor the PUCT may amend the qualified rate order in any manner that would impair the rights of the "securitized" bondholders.

Additional Impacts of Senate Bill 7

Municipal Utilities and Electric Co-ops are largely exempt from the requirements of SB 7 that apply to IOUs. While IOUs became subject to retail competition beginning on January 1, 2002, the governing bodies of Municipal Utilities and Electric Co-ops have the sole discretion to determine whether and when to opt-in to retail competition. However, if a Municipal Utility or Electric Co-op has not voted to opt-in, it will not be able to compete for retail energy customers at unregulated rates outside its traditional electric service area or territory.

SB 7 preserves the PUCT's regulatory authority over electric transmission facilities and open access to such transmission facilities. SB 7 provides for an independent transmission system operator (an ISO as previously defined) that is governed by a board comprised of market participants and independent members and is responsible for directing and controlling the operation of the transmission network within ERCOT. The PUCT has designated ERCOT as the ISO for the portion of Texas within the ERCOT area. In addition, SB 7 (as amended by the Texas Legislature after 1999) directs the PUCT to determine electric wholesale transmission open access rates on a 100% "postage stamp" pricing methodology.

The greatest potential impact on CPS' electric system from SB 7 could result from a decision by the City Council and the Board to participate in a fully competitive market, particularly in light of the fact that CPS is among the lowest cost

producers of electric energy in Texas. On April 26, 2001, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002. However, CPS currently believes that it is taking all steps necessary to prepare for possible competition in the unregulated energy market, should the City Council and the Board make a decision to opt-in, or future legislation forces Municipal Utilities and Electric Co-ops into retail competition.

Any future decision of the City Council and the Board to participate in full retail competition would permit CPS to offer electric energy service to customers located in areas participating in retail choice that are not presently within the certificated service area of CPS. The City Council and the Board could likewise choose to open the CPS service area to competition from other suppliers while choosing not to have CPS compete for retail customers outside its certified service area.

As discussed above, Municipal Utilities and Electric Co-ops will also determine the rates for use of their distribution systems after they open their territories to retail competition, although the PUCT has established by rule the terms and conditions applicable to have access to those systems. SB 7 also permits Municipal Utilities and Electric Co-ops to recover their stranded costs through collection of a non-bypassable transition charge from their customers if so determined by such entities through procedures that have the effect of procedures available to IOUs under SB 7. Unlike IOUs, the governing body of a Municipal Utility determines the amount of stranded costs to be recovered pursuant to rules and procedures established by such governing body. Municipal Utilities and Electric Co-ops are also permitted to recover their respective stranded costs through the issuance of bonds in a similar fashion to the IOUs. Any decision by CPS as to the magnitude of its stranded costs, if any, would be made in conjunction with the decision as to whether or not to participate in retail competition.

A Municipal Utility that decides to participate in retail competition and to compete for retail customers outside its traditional service area will be subject to a PUCT-approved code of conduct governing affiliate relationships and anti-competitive practices. The PUCT has established by a standard rule the terms and conditions, but has no jurisdiction over the rates, for open access by other suppliers to the distribution facilities of Municipal Utilities electing to compete in the retail market. If a Municipal Utility decides to participate in retail competition, its customers are subject to being charged a PUCT-approved System Benefit Fund fee per megawatt hour beginning six months prior to implementation of customer choice. The fee is a contribution to a statewide fund targeted at property tax replacement, low-income programs and customer education.

Among other provisions, SB 7 provides that nothing in the act or in any rule adopted under it may impair any contracts, covenants, or obligations between municipalities and bondholders of revenue bonds issued by municipalities and that nothing in the act may impair the tax-exempt status of municipalities or compel them to use facilities in a manner that violates any bond covenants or other exemption of interest or tax-exempt status. The bill also improves the competitive position of Municipal Utilities by allowing local governing bodies, whether or not they implement retail choice, to adopt alternative procurement processes under which less restrictive competitive bidding requirements can apply and to implement more liberal policies for the sale and exchange of real estate. Also, matters affecting the competitiveness of Municipal Utilities are made exempt from disclosure under the open meetings and open records acts and the right of municipal utilities to enter into risk management and hedging contracts for fuel and energy is clarified. See "FUEL SUPPLY", "WHOLESALE POWER MARKETING" and "RISK MANAGEMENT" for discussion of CPS' Price Risk Management Program.

During its 79th Legislative Session in 2005, the Texas Legislature reviewed the mission and performance of the PUCT, as required by the Texas Sunset Act. This Act provides that the Sunset Commission, composed of legislators and public members, periodically evaluate a state agency to determine if the agency is still needed, and what improvements are needed to ensure that tax dollars are appropriately utilized. Based on recommendations of the Sunset Commission, the Texas Legislature ultimately decides whether an agency continues to operate into the future.

The 79th Legislature in its review of the PUCT, reauthorized the agency until 2011. Reforms were enacted to increase the accountability of ERCOT, including added regulatory scrutiny and governance changes that add independence while preserving input from industry experts. An "independent market monitor" selected by and reporting to the PUCT, was institutionalized to help guard against manipulation in the Texas wholesale electric market. No significant, direct impact on CPS is anticipated as a result of this legislation.

Post Senate Bill 7 Wholesale Market Design Developments

In the summer of 2003, the PUCT adopted rules requiring that ERCOT transition from a zonal to a nodal wholesale market by October 1, 2006, and requiring that new protocols to accomplish this transition be submitted to the PUCT for review. Implementation of the nodal market will include, among other elements: direct assignment of the costs of local transmission congestion to market participants that cause the congestion; implementation of an integrated, financially binding day-ahead market; and nodal energy prices for resources and zonal energy prices for loads. Consistent with the rule, ERCOT and industry stakeholders have developed and submitted to the PUCT protocols and proposed energy load zones to implement these market design elements, together with an independent cost-benefit analysis. The PUCT in 2005 reaffirmed its intent to implement the nodal market in ERCOT, but modified the implementation date to January 1, 2009. In December 2005, the PUCT conducted a hearing on the nodal protocols submitted by ERCOT, and in April 2006 it issued an order approving the implementation of the nodal market. ERCOT has begun its process of design specification and implementation, which will be followed by design specification and implementation by market participants, including CPS. These activities will continue through early 2008, followed by integration testing and trials leading to the January 1, 2009 implementation date. See "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation" herein.

The 80th Texas Legislative Regular Session adjourned on May 28, 2007. While certain legislation was enacted, CPS believes that this legislation will have no material adverse impact on the Systems, including its financial and other operations.

Environmental Restrictions of Senate Bill 7 and Other Related Regulations

SB 7 contains specified emissions reduction requirements for certain older electric generating units, which would otherwise be exempt from the Texas Commission on Environmental Quality ("TCEQ") permitting program by virtue of "grandfathered" status. Under SB 7, annual emissions of nitrogen oxides ("NO_x") from such units were reduced by 50% from 1997 levels, beginning May 1, 2003. These emissions have been reported on a yearly basis and CPS has met the requirements of its NO_x cap for the applicable units for the past three compliance years. CPS has final Electric Generating Facility ("EGF") State permits from the TCEQ for its four older electric generating plant sites, comprising of 11 gas-fired units. CPS may require future additional expenditures for emission control technology. See "ENVIRONMENTAL MATTERS – Federal Clean Air Act" and "CONSTRUCTION PROGRAM" for a discussion of the cumulative economic effect of these requirements together with requirements under Federal Clean Air Act permits.

Although SB 7 instituted many of the changes to environmental emission controls which affect grandfathered electric generating plants, another TCEQ regulation, Chapter 117, is directed at all units in the state, including CPS' coal plants. These regulations required a 50% reduction in NO_x emissions statewide beginning May 1, 2005 and system-wide on an annual basis. The first reporting period for CPS' power plants subject to the Chapter 117 cap was for the compliance period May 1, 2005 to April 2006. CPS has met the Chapter 117 cap for each compliance period. As a result of the J.K. Spruce Plant Unit 2 ("JKS 2") air permitting process, CPS has committed to tighter NO_x emission limitations than what is required under Chapter 117 at the Calaveras Lake site once the JKS 2 unit comes on line. The final Clean Air Interstate Rule ("CAIR") has imposed even more NO_x restrictions on CPS power plants as described in "ENVIRONMENTAL MATTERS". Changes to environmental emission controls may have the greatest effect on coal plants. For example, mercury emission limits have been finalized by the Environmental Protection Agency ("EPA"), which may require new controls at the coal plants in the near future as is discussed in "ENVIRONMENTAL MATTERS – Federal Clean Air Act" herein. Further statutory changes and additional regulations may change existing cost assumptions for electric utilities. While it is too early to determine the extent of any such changes, such changes could have a material impact on the cost of power generated at affected electric generating units.

RESPONSE TO COMPETITION

In order to prepare to operate successfully in the new competitive environment created by the enactment of SB 7, CPS has developed a marketing plan that focuses on retaining the retail customers in its historic service areas and active participation in wholesale markets. Programs concentrate on not only meeting all customers' traditional needs, but also on providing products and services that provide comfort and convenience for residential customers and improve productivity and reduce costs for commercial and industrial customers. In addition, CPS is improving internal and external communications, promoting participation in a wide variety of community initiatives, staying actively involved with regulatory issues, and focusing on the strategies and objectives at the corporate and business unit levels which have been identified as critical to success.

Looking to the future, CPS plans to continue providing low cost generation and high levels of reliability to the communities it serves, while working on customer retention by improving and developing strong customer loyalty. As a step in diversifying its energy resource plan, CPS is aggressively pursuing renewable energy supplies. CPS is currently receiving renewable energy under long term, 20-year contracts for 160 megawatts ("MW") of wind-generated electricity from the Desert Sky Wind Project, in Pecos County and for 100 MW from the Cottonwood Creek Wind Farm located south of Sweetwater, Texas. CPS has also signed 20-year contracts for an additional 240 MW from an expansion to the Cottonwood Creek Wind Farm. This expansion is expected to be operational by December 2007. CPS also has a landfill gas-generated energy project totaling 9.6 MW which came on-line in December 2005. This capacity totals more than 510 MW in service or under contract. CPS has one of the most aggressive renewable energy programs in Texas with a renewable capacity equivalent to nearly 11.6% of its historic peak power requirement.

With respect to state and national legislative action regarding competition, CPS continues to participate actively in the legislative process to voice the interests of Municipal Utilities and play an integral part in shaping the new environment in which it will operate. CPS continues to evaluate the price components of the energy services it provides, recognizing that the price for electricity will be a paramount factor for succeeding in a deregulated environment. Cost containment initiatives coupled with additional phases of debt management strategies will continue in the years ahead.

In conjunction with the onset of deregulation and retail competition, overall merchant plant activity in ERCOT increased significantly in recent years, with more than 30,485 MW of new generation completed since wholesale competition was introduced in September 1995. The result of these capacity additions has been a strong downward pressure on wholesale power prices that, in turn, has led several companies to decommission or "mothball" less efficient power plants. According to information posted at the PUCT website, as of March 6, 2007, 15 facilities (6,261 MW) were mothballed since September 1995 and 27 facilities have been retired (3,625 MW) since 2002. Wholesale prices recovered during the summer of 2005 due to strong demand and higher temperatures. CPS was a net seller of power when excess capacity was available. The market is constantly monitored, and CPS continues to purchase or sell on a daily basis to optimize use of its generation portfolio.

Strategic Planning Initiatives

CPS has a comprehensive corporate strategic plan that is designed to make CPS more efficient and competitive, while delivering value to its various customer groups and the City. On August 22, 2005 the Board approved a new strategic plan, developed by a cross-functional team. The plan built on the CPS mission, vision, and core values as well as long-term goals adopted in 2004 as part of the Vision 2020 process. The strategic plan has evolved to formulate plans for its wholesale, retail, transmission and distribution, gas, and shared services business units. Each plan will be the responsibility of the business unit and will focus on market tactics, organizational development, business information, process improvement, legal/regulatory issues and financial accomplishment. The senior executive for each business unit has accountability for development and delivery of the plan.

Major initiatives and key action plans necessary to accomplish the objectives and meet or exceed the targets are also included in each plan. Status reports are provided to the Board and senior management on a regular basis. An oversight team, appointed by senior management, ensures consistency with Vision 2020 and directs the resolution of cross-business unit issues.

Debt and Asset Management Program

CPS has developed a debt and asset management program ("Debt Management Program") for the purposes of lowering the debt component of energy costs, maximizing the effective use of cash and cash equivalent assets and enhancing financial flexibility. An important part of the Debt Management Program is debt restructuring through the prudent employment of variable rate debt and possible interest rate swap contracts. It is anticipated, however, that the variable rate exposure of CPS will not exceed 25% of total outstanding debt. The program also focuses on the use of unencumbered cash and available cash flow to redeem debt ahead of scheduled maturities as a means of reducing outstanding debt. The Debt Management Program is designed to lower interest costs, fund strategic initiatives and increase net cash flow.

Current Economic Developments

CPS works independently as well as with the San Antonio Economic Development Foundation and other local economic development agencies to recruit targeted businesses into the CPS service territory. The 2006 CPS corporate strategic planning initiative included an exercise to revise the list of business targets to pro-actively recruit into the service area. This analysis concluded that recruitment, retention and expansion of the following industries have the most potential advantage to CPS: advanced manufacturing (including aviation, aerospace, automotive), life sciences/bio-medical, homeland security, information technology (including data centers, financial service centers, insurance and back office operations) and large-scale retail developments.

During 2006, CPS' economic development recruitment efforts have resulted in a total of 23 corporate locations with the potential to create over 4,000 new jobs. The largest of these company announcements include Sino-Swearingen (a business jet manufacturer), Lowes Companies (data center), Cadillac Automotive Products (automotive component parts manufacturer), American Funds (financial services), Accenture (customer care center) and Afni (call center).

Work continues on the Texas Cryptologic Center in San Antonio. The Texas Cryptologic Center has committed to establish a regional cryptology center to support its communications intelligence – retaining and creating almost 2,000 jobs over the next few years. At full build-out, this center could result in an additional load of over 40MW onto the CPS system.

Production began in late 2006, at the Toyota Motor Manufacturing Texas ("TMMTX") facility in San Antonio. The first of the "Texas Tundra" trucks are now in dealer showrooms across the country. The facility is ramping up production to 150,000 trucks per year. TMMTX has hired over 1,800 individuals to date and is on its way to a projected total employment of 2,000. Additionally, full production is underway at the on-site vendor park for the 21 Tier One suppliers who are employing over 2,100 persons. The combined investment of the TMMTX facility and their on-site suppliers equals \$1.1 billion. CPS will initially supply an estimated 32 MW electric load and gas transport for the delivery of 770,000 MMBtu/year for the project. TMMTX and CPS have an agreement in place that calls for TMMTX to obtain electricity and transport natural gas services exclusively from CPS for 15 years from the start of production.

The first quarter of 2007, has seen continued new economic developments for the CPS service territory. Microsoft Corporation announced in January that a new \$550 million data center will be built in the western portion of the service territory. CPS staff worked with Microsoft for over one year to recruit this data center and its potential 40 MW load. Plans are for the center to be operational in June 2008. As a result of Microsoft and Lowes, CPS has received inquiries from and is actively pursuing several additional data center projects. One of the principal reasons these centers are considering San Antonio is the presence of CPS – a municipally-owned utility providing reliable, competitive electric service to companies that demand high quality and reliable electric service.

While attracting new companies is important, CPS economic development efforts also focus on the retention and expansion of existing companies. During the 1st quarter of 2007, efforts to retain existing companies resulted in keeping one major company from looking elsewhere. Maxim Integrated Products has made the decision to expand in San Antonio by refurbishing and occupying an existing building next to their present site as opposed to expanding their operations at competing plant locations in Japan and California. The Maxim expansion will result in CPS keeping a 6 MW load customer and increasing their electric usage by an estimated 20%.

CONSTRUCTION PROGRAM

Comprehensive programs for planning and construction to meet current and future electric and gas systems needs are continually being reviewed and updated. CPS utilizes computer-based mathematical models for its forecasting processes. CPS bases its near-term construction and operating needs on a five-year forecast. This short-term annual forecast is supported by a 35-year electric resource plan and a 25-year electric transmission facilities plan. These assumptions are subject to substantial change and will be revised as necessary to maintain CPS' competitive position.

In addition, CPS expects to see continued growth in its customer base for the electric and gas systems due to projected population growth in the San Antonio area. The energy sales forecast predicts annual increases of 3.54% and 0.23% in electric and gas sales, respectively, over the next 25 years. The summer 2006 forecast projects a peak demand growth rate averaging 3.16% per year for the next 25 years. CPS has continued to expand its electric customer extensions, with ongoing construction growth in this area. The capital projects in fiscal year 2007-08 are planned to be funded with transfers from the Repair and Replacement Account, debt proceeds, and other sources.

A capital improvement plan is made for planning purposes and may identify projects that will be deferred or omitted entirely in future years, and in addition, the proposed funding sources for the plan may be modified to meet changing conditions. Likewise, as conditions change, new projects may be added that are not currently identified. CPS' current \$4.294 billion, five-year capital improvement plan is forecasted from February 1, 2007 to January 31, 2012. Construction projects include electric transmission, electric generation, electric distribution, general properties, and gas facilities.

Over the five-year period covered by the current capital plan, construction funding from debt proceeds averages approximately \$550.0 million per year, with other major sources of funding for the plan consisting of internally generated funds.

The Community Infrastructure and Economic Development Fund ("CIED") was established by Board policy on January 19, 2005, as a successor to the Overhead Conversion Fund ("OCF"). The OCF was originally instituted in 1993, by the Board in response to interest by the citizens and governing bodies of the City and the suburban cities within the CPS service area to enhance the aesthetic appeal of the public areas by minimizing the visual impact of overhead electric facilities. The OCF amount, set annually, equaled one percent (1%) of the base electric revenue (less uncollectibles) of the CPS electric system billed during the previous fiscal year to retail electric customers of CPS residing within the City and each of the suburban cities. For several reasons, including the high cost of converting overhead facilities to underground, the City and the suburban cities had difficulty spending the OCF monies on an annual basis. In late 2004, CPS was asked to consider expanding the potential uses of the fund. CPS will continue to make all or any part of the monies available for "traditional" OCF projects (re-routing or undergrounding), but will also make the funds available for certain eligible economic development and environmental stewardship/energy efficiency projects. Such projects are evaluated for their ability to improve the environment, create new jobs, and generate new electric and gas revenues. Both of these new allowable uses (economic development and environmental stewardship) require a positive cost-benefit finding, meaning that CPS is likely to receive greater economic return as a result of the project being eligible to receive CIED Fund monies and other investments applied toward the project. Additionally, economic development and environmental stewardship allocations from the CIED Fund can only be applied towards capital projects owned by a public purpose entity. The CIED Fund allocable to all the beneficiary entities as of January 31, 2007 totaled \$66.2 million.

By further policy change effective January 2006 and by City ordinance passed in February 2006, CPS agreed to transfer monies allocable to the City under the CIED Fund Policy. The transfer is subject to the limitations that the: (1) total annual City transfer from the gross revenue of the Systems, inclusive of the CIED fund transfers, does not exceed 14% of CPS' total gross revenues (in compliance with the Bond Ordinances) and (2) the CIED fund transfer does not exceed 1% of electric base rates paid by residents of the City.

DESCRIPTION OF PHYSICAL PROPERTY

ELECTRIC SYSTEM

Generating Plants

CPS operates 19 electric generating units, three of which are coal-fired and 16 of which are gas-fired. Some of the gas-fired generating units may also burn fuel oil, which provides greater fuel flexibility and reliability. With the acquisition of an additional 300 MW purchased from AEP Texas Central Company ("AEP TCC"), as of May 19, 2005, CPS has a 40.0% interest in STP's two nuclear generating units. The nuclear units supplied 38% of the electric system load during fiscal year 2006 - 07. See "South Texas Project" herein.

The J.T. Deely, J.K. Spruce, and O.W. Sommers Plants are located at Calaveras Lake southeast of the City and share the lake's cooling capacity. The J.T. Deely Plant consists of two units that are equipped to burn coal. Like the Deely Plant units, the J.K. Spruce Plant burns low sulfur western coal from the Powder River Basin area of Wyoming. Additional agreements with other suppliers are initiated as needed for additional purchases of coal. These three coal units provided 43.6% of the electric system load for fiscal year 2006-07. The O.W. Sommers Plant comprises two units, which are capable of operating on either natural gas or fuel oil.

CPS entered into a financial lease/leaseback transaction with an affiliate of Unicom Corporation involving CPS' J.K. Spruce Unit 1 in June 2000. Unicom Corporation has subsequently merged into Exelon Corporation. The Balance Sheets and related notes in APPENDIX B include items related to this transaction. See discussion under "POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS" herein.

The V.H. Braunig Plant is located on Braunig Lake, also southeast of the City. It has three units that can operate on either natural gas or fuel oil.

The Arthur von Rosenberg Plant, located adjacent to the V.H. Braunig Plant, uses a combined cycle operation to generate 15.0% more electric power from natural gas than other gas generation methodologies. The plant also utilizes an environmental control system producing NO_x emissions below other existing CPS plants and 95.0% lower than the national average for fossil fuel-fired plants.

While STP and the plants at Calaveras and Braunig lakes now provide most of CPS' generation, two older plants are also available to provide generation during peak load periods. They are the W.B. Tuttle Plant and the Leon Creek Plant. These plants burn only natural gas and are cooled by ground water re-circulated through cooling towers. In June 2004, four new natural gas combustion turbine peaking units were added to the Leon Creek Plant site. The W.B. Tuttle Unit 2 and the Leon Creek Unit 4 have been mothballed. Leon Creek Unit 4 is planned to return to service in the summer of 2007. The W.B. Tuttle Unit 2 will be retired. The W.B. Tuttle Unit 1 and Leon Creek Unit 3 have been de-rated, reducing their generating capability. The reduction in generating capability is negligible since it is less than one percent of CPS' total generating capacity.

The peak load for fiscal year 2006-07, was 4,407 MW. On August 17, 2006 a new peak was reached at 4,407 MW, which broke the record peak of 4,374 set the previous day. With a generating capacity of 5,216 MW at the time of the new peak, the reserve margin was 15.5%. See "Generating Capability" herein.

Authorization to proceed with the permit application on a new coal-fired unit was received from the Board in late June 2003. In November 2003, CPS filed with TCEQ an application for permits associated with construction and operation of a new 750 MW coal-fired generating station to be co-located with the J.K. Spruce Plant Unit 1 coal-fired generating station. The TCEQ approved the permit in December 2005. The ground breaking for the new coal-fired unit took place on March 21, 2006, and in-service date is planned for summer 2010. Construction is being performed under a fixed-price contract by the Calaveras Power Partners, a partnership of Black & Veatch, Zachry Construction and The Industrial Company. See "ENVIRONMENTAL MATTERS – Other Environmental Issues" for further discussion.

CPS is planning to add approximately 200 MW of combustion turbine peaking units to the V.H. Braunig Plant site. The number of units and capacity of each unit will be determined later in 2007 as engineering work progresses. The new units are scheduled to be operational by the summer of 2009.

Braunig Lake has additional cooling capability for future generating units. This man-made lake covers approximately 1,350 surface acres and utilizes treated sewage effluent and runoff waters. CPS was a pioneer in the use of non-potable, recycled water for cooling purposes, thereby saving higher, potable quality underground water for other uses.

San Antonio Water System ("SAWS") is obligated to provide 40,000 acre-feet of treated wastewater per year to CPS. CPS may increase this amount by two contingent 5,000 acre-feet options that are dependent on the availability of the sewage effluent, at prices escalated to the date of exercise. Current water needs are being met with the original SAWS 40,000 acre-feet obligation. Due to system growth and construction of new generating units and to assure adequate water supplies in the future, CPS has asked to exercise its first option that expires in June 2007. The second option expires in 2011. CPS projects that these contract volumes, along with water available under existing permits, will provide sufficient cooling capacity for any planned generation units at these lakes.

CPS owns 1,274 aluminum railroad cars which are used in unit trains to haul coal from mines in Wyoming and other locations to the J.T. Deely Plant and the J.K. Spruce Plant. CPS performs its own railroad car maintenance and servicing at its railroad car maintenance facility located at Calaveras Lake.

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Generating Capability

Plant ¹		Fuel	Year Installed	Net Capability MW ²	Total Capability MW ²
STP (40.0% interest) ³	Unit 2	Nuclear	1989	540	
	Unit 1	Nuclear	1988	540	1,080 Nuclear
J.K. Spruce Plant	Unit 1	Coal	1992	595	
J.T. Deely Plant	Unit 2	Coal	1978	415	
	Unit 1	Coal	1977	415	1,425 Coal
A. von Rosenberg Plant ⁴	Unit 1	Gas	2000	481	
O.W. Sommers Plant	Unit 2	Gas/Oil	1974	435	
	Unit 1	Gas/Oil	1972	445	
V.H. Braunig Plant	Unit 3	Gas/Oil	1970	420	
	Unit 2	Gas/Oil	1968	240	
	Unit 1	Gas/Oil	1966	225	
W.B. Tuttle Plant	Unit 3	Gas	1961	100	
	Unit 2 ⁵	Gas	1956	0	
	Unit 4 ⁶	Gas	1963	160	
	Unit 1 ⁶	Gas	1954	50	
Leon Creek Plant	Unit 4 ⁵	Gas	1959	0	
	Unit 3 ⁶	Gas	1953	60	
	CT 4 ⁷	Gas	2004	47.5	
	CT 3 ⁷	Gas	2004	47.5	
	CT 2 ⁷	Gas	2004	47.5	
	CT 1 ⁷	Gas	2004	47.5	2,806 Gas/Oil
Total Capability owned by CPS				<u>5,311</u>	<u>5,311</u>
Purchased Power:					
Desert Sky Wind Farm		Wind	2002	160	
Cottonwood Creek Wind Farm		Wind	2005	100	260 Wind
Covel Gardens		Landfill Gas	2005	9.6	9.6 Landfill Gas
Total Purchased Power				<u>269.6</u>	<u>269.6</u>
Total Capability including Wind and Landfill Gas				<u>5,580.6</u>	<u>5,580.6</u>

(1) At January 31, 2007.

(2) For gas/oil fueled units, the capabilities shown are the gas ratings.

(3) STP Units 1 and 2 are performing at increased capabilities due to upgrades. See "South Texas Project" below.

(4) Net capability reflects summer rating.

(5) W.B. Tuttle Unit 2 and Leon Creek Unit 4 have been mothballed. W.B. Tuttle Unit 2 will be retired and Leon Creek Unit 4 is planned to returned to service in summer of 2007.

(6) W.B. Tuttle Unit 1 (from 65 MW to 50 MW), and Leon Creek Unit 3 (from 65 MW to 60 MW) were de-rated.

(7) Combustion Turbine.

South Texas Project

STP is a two-unit nuclear power plant; Unit 1 and Unit 2 have a nominal output of approximately 1,350 MW each. STP is located on a 12,220 acre site in Matagorda County, Texas, near the Texas Gulf Coast, approximately 200 miles from San Antonio. CPS currently owns 40.0% of STP. On February 2, 2006, NRG Energy ("NRG Energy"), headquartered in Princeton, New Jersey, acquired all the outstanding equity of Texas Genco LLC, the parent of Texas Genco LP, including its interest in STP.

STP Participant Ownership ("Participants") in the STP and their shares therein are as follows:

Participants	Ownership Effective February 2, 2006	
	%	MW (approximate)
NRG Energy	44.0	1,188
CPS	40.0	1,080
City of Austin-Austin Energy	16.0	432
	<u>100.0</u>	<u>2,700</u>

STP is maintained and operated by a non-profit Texas corporation ("STP Nuclear Operating Company") financed and controlled by the owners pursuant to an operating agreement among the owners and STP Nuclear Operating Company. Currently, a four-member board of directors governs the STP Nuclear Operating Company, with each owner appointing one member to serve with the STP Nuclear Operating Company's chief executive officer. All costs and output continue to be shared in proportion to ownership interests.

STP Units 1 and 2 each have a 40-year NRC license that expires in 2027 and 2028, respectively. No firm decision has been made with respect to license extension; however, under NRC regulations, the STP owners may not make a license extension request until the plant licenses are within 20 years of the license expiration date.

During the twelve-months ended January 31, 2007, the STP Units 1 and 2 operated at approximately 93.1% and 102.5% of net capacities, respectively. Unit 1 completed a normal refueling outage in the fall of 2006 which included replacement of all three low pressure turbines. Unit 2 completed a normal refueling outage in the spring of 2007 in which all three of its low pressure turbines were replaced. The replacement of low pressure turbines and other plant upgrades during these outages improved plant efficiency and yielded an average increase in electrical output of approximately 68 MW in each unit.

Five-Year South Texas Project Capacity Factor

	Calendar Years Ended December 31,					2007 ²
	2002	2003 ¹	2004	2005	2006	
Unit 1	99.2%	62.6%	100.8%	90.0%	92.6%	93.1%
Unit 2	<u>75.0</u>	<u>81.4</u>	<u>93.7</u>	<u>90.6</u>	<u>102.5</u>	<u>102.5</u> ³
Total	87.1%	72.0%	97.2%	90.3%	97.6%	97.8%

(1) Unit capacities in 2003 were lower than typical capacity values because of the unplanned outages in both units.

(2) Twelve months ended January 31, 2007.

(3) Capacity Factor based on nameplate rating of 1250.6 MW per unit.

Recent operational highlights for STP include the following: In 2006, for the third year in a row, STP led the nation in generation from a two-unit site. In total generation, Unit 2 ranked #1 in the U.S. and #3 in the world. Despite the planned outage, Unit 1 ranked #6 in the U.S. and #17 in the world.

The NRC evaluates plant performance by analyzing two distinct inputs: inspection findings from the NRC's inspection program and performance indicators that are reported by the licensee. Inspection findings and performance indicators are given a color designation based on their safety significance. The current plant assessment for STP can be found at a summary level at http://www.nrc.gov/NRR/OVERSIGHT/ASSESS/pim_summary.html, or by writing to U.S. Nuclear Regulatory Commission, Public Document Room, O-1F-13, Washington, D.C. 20555.

The NRC rules require that each holder of a nuclear plant operating license submit to the NRC a decommissioning plan which contains, among other things, a cost estimate for decommissioning such plant and either a funding plan or a guaranty method for covering decommissioning costs for such plant. Participants in STP have filed a decommissioning plan for the STP in compliance with these rules, which includes representations by each STP Participant that it has established a trust into which it annually pays, throughout the life of the STP, amounts which, when accumulated with investment income, will provide the funds required by the rules to pay its respective portion of such costs.

CPS maintains decommissioning funds for its 28.0% interest in STP separate from decommissioning funds associated with its recently acquired 12.0% STP interest ("former AEP TCC interest") to meet its decommissioning obligations for its entire 40.0% interest in STP. See Note 11 to CPS' audited financial statements in APPENDIX B. As of December 31, 2006, the CPS balance in the City Public Service Restated Decommissioning Master Trust for the South Texas Project Decommissioning Trust ("STP Decommissioning Trust") to decommission CPS' 28.0% interest in STP was \$254.9 million and exceeded NRC requirements by \$167.6 million. With respect to decommissioning funds for the former AEP TCC interest, the acquisition by CPS and Texas Genco of AEP TCC's interest in STP includes, proportionately, the responsibility for decontamination and decommissioning, but also resulted in the transfer of decommissioning funds held in trust by AEP TCC. Under PUCT Substantive Rule 25.303, AEP TCC will continue to collect decommissioning fees from its historical retail customers, which are paid into new trust accounts applicable to the new shares of STP acquired by CPS and Texas Genco. These fees are subject to review and adjustment by the PUCT at its initiative or at the request of an interested person including CPS or Texas Genco. As of December 31, 2006, the CPS balance in the Decommissioning Master Trust Related to the South Texas Project Interest Acquired from AEP Texas Central Company, "Master Trust (TCC

Funded)" was \$82.2 million. As of December 31, 2006, the balance in the Master Trust to decommission CPS' 12.0% interest in STP exceeded NRC requirements by \$44.8 million. See "INVESTMENTS – STP Decommissioning Funds" and "Master Trust (TCC Funded)" for information concerning the value of investments in the decommissioning trusts. Actual decommissioning costs could vary substantially from the estimate of such costs depending on future regulatory requirements, the method used for decommissioning, and other factors, and the amounts in the decommissioning trusts may or may not be adequate to pay these costs.

On June 21, 2006, NRG Energy announced its intention to build several different power plants to add to its existing generation portfolio. As part of this announcement, NRG Energy stated that it had filed a letter of intent with the NRC to build two additional nuclear units at the STP site. While consent from at least one of the other existing STP owners is required for construction of additional units at STP, NRG Energy has started the NRC licensing process for those units on its own. CPS has not made any decision whether it will participate in the development of new nuclear units at STP. Similar to other opportunities to build or purchase existing power plants, CPS has formed a team that has been evaluating the merits of NRG Energy's proposal.

Qualified Scheduling Entity

CPS operates as an ERCOT Level 4 Qualified Scheduling Entity ("QSE") representing all of CPS' assets and load. The communication with ERCOT and the CPS power plants is monitored and dispatched 24 hours per day/365 days a year. Functions are provided from the Energy Market Center housed within the main office. Backup facilities have also been created. QSE functions include load forecasting, day ahead and real time scheduling of load, generation and bilateral transactions, generator unit commitment and dispatch, communications, invoicing and settlement.

Transmission System

CPS maintains a transmission network for the movement of large amounts of electric power from generating stations to various parts of the service area and to or from neighboring utilities and for wholesale energy transactions as required. This network is composed of 138 and 345 kilovolt ("kV") lines with autotransformers to provide the necessary flexibility in the movement of bulk power.

Interconnected System

The electric system is integrated with more than 100 other utilities, municipalities, independent power producers, power marketers, and co-operatives in Texas to form ERCOT which covers a large portion of Texas. The ERCOT system is operated entirely within the State and is connected to other reliability councils and Mexico through three direct-current lines, providing only limited import/export capability. CPS and the nine utilities below are the major transmission entities in ERCOT:

American Electric Power Service Corporation
Brazos Electric Power Co-op
City of Brownsville Public Utilities Board
South Texas Electric Co-op/Medina Electric Co-op
TXU Electric Delivery, subsidiary of TXU Corp.

Austin Energy
CenterPoint Energy
Lower Colorado River Authority
Texas Municipal Power Agency

The transmission facilities of the nine above entities, along with CPS, have been integrated into a single control area, which is operated by ERCOT acting as the ISO. ERCOT operates the transmission grid through each of the transmission-owning entities that maintain direct control and maintenance of their respective portions of the transmission infrastructure.

Pursuant to the PUCT's open access transmission rule, discussed under "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation", ERCOT members and other wholesale market participants jointly established, by a filing with the PUCT in 1996, the ERCOT organization as an ISO and an integrated electronic transmission information network. ERCOT's responsibilities, which were augmented in 1999 under SB 7 for the pending retail competitive market, include daily administration of the ERCOT transmission tariffs, including alternate dispute resolution procedures, coordination of the scheduling of ERCOT generation and transmission, directing the redispatch of ERCOT generation and transmission transactions for economic purposes, preserving system reliability, and administering the electronic transmission information network. ERCOT also manages commercial operations of the wholesale power market as well as acts as a single clearinghouse for retail customer switches and metering information. ERCOT does not

purchase or sell bulk electricity, nor does it dispatch generation facilities. Beginning July 31, 2001, ERCOT began operating the interconnected system as a single control area, in contrast to the multiple control areas historically in place, as part of the transition to the retail competitive market, which was fully implemented on January 1, 2002. As a participant as a generation entity, load serving entity, and transmission owner in the ERCOT wholesale market, CPS is obligated to comply with all rules established by ERCOT as reflected in its protocols and operating guides, which are subject to change from time to time and subject to oversight and review by the PUCT. ERCOT's costs of converting to a single control area and of administering system operations for the competitive retail market are recovered through an administrative fee assessed to system participants, including CPS, allocated on a load-ratio share basis. CPS recovers the fee through the billing adjustment discussed above under "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments".

Distribution System

The distribution system is supplied by 72 substations strategically located on the high voltage 138 kV transmission system. The central business district of the City is served by nine underground networks, each consisting of four primary feeders operated at 13.8 kV, transformers equipped with network protectors, and both a 4-wire 120/208 volt secondary grid system and a 4-wire 277/480 volt secondary spot system. This system is well designed for both service and reliability.

Approximately 7,580 circuit miles (three-phase equivalent) of overhead distribution lines are included in the distribution system. These overhead lines also carry secondary circuits and street lighting circuits. The underground distribution system consists of 321 miles of three-phase equivalent distribution lines, 83 miles of three-phase Downtown Network distribution lines, and 3,738 miles of single-phase underground residential distribution lines. Many of the residential subdivisions added in recent years are served by underground residential distribution systems. At January 31, 2007, the number of street lights in service was 70,845. The vast majority of the lights are high-pressure, sodium vapor units.

GAS DISTRIBUTION SYSTEM

Supply Pressure System

The supply pressure system consists of a network of approximately 200 miles of steel mains that range in size from 4 to 30 inches. The entire system is coated and cathodically protected to mitigate corrosion. The supply pressure system operates at pressures between 50 psig and 274 psig, and supplies gas to 266 pressure regulating stations throughout the gas distribution system which reduce the pressure to between 9 psig and 59 psig for the distribution system. A Supervisory Control and Data Acquisition ("SCADA") computer system monitors the gas pressure and flow rates at many strategic locations within the supply pressure system, and most of the critical pressure regulating stations and isolation valves are remotely controlled by SCADA.

Distribution System

The gas distribution system consists of approximately 4,740 miles of 2 to 16-inch steel mains and 1-1/4 to 6-inch high-density polyethylene (plastic) mains. The distribution system operates at pressures between 9 psig and 59 psig. All steel mains are coated and cathodically protected to mitigate corrosion. The vast majority of the gas services are connected to the distribution system, and the gas normally undergoes a final pressure reduction at the gas meter to achieve the required customer service pressure. Critical areas of the distribution system are remotely monitored by SCADA.

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OTHER ELECTRIC AND GAS SYSTEMS STATISTICS¹

	Electric System			Gas System
	Transmission System	Overhead Distribution System	Underground Distr. System & Network	Generation System Gas Pipe Line
Substations	16 ³	72		
Miles of Lines	1,417	7,580	4,701 ⁴ 83 ⁵	
Kilovolts	138/345	13.2/34.5	13.2/34.5	
Miles of Main (Generation: South Gate Pipe Line and Other)				69
Main Sizes (inches)				24 - 30
Main Pressures (psig)				275 - 1,118
Miles of Main (North Gate Pipeline)				
Main Sizes (inches)				17
Main Pressures (psig)				24
				931 - 1,118 ⁶

(1) As of January 31, 2007.

(2) Supply Pressure System and Distribution System.

(3) Includes switchyards.

(4) Underground single phase, includes 321 miles three-phase commercial, industrial lines.

(5) Downtown Network three-phase.

(6) Maximum allowable operating pressure.

GENERAL PROPERTIES

Operation Control System

A new primary operations and control center, the Energy Management Center ("EMC"), constructed on the east side of San Antonio was brought on line in October 2004. From this location, system operators use SCADA systems to monitor and control the CPS electric transmission and distribution systems, and the CPS gas supply pressure and distribution systems. All substations, power plants and major gas regulating points are continually monitored and displayed on one-line diagrams on video screens. Abnormalities register an alarm and the system operator can reset certain circuit breakers and valves as required, maintaining delivery of gas or electric service. In addition to the control capability, the system gathers data that is recorded on a computer for various reporting needs. The operation and control function located at the Jones Avenue facility, upgraded and expanded in 1999, serves as the secondary/back-up control center to ensure continued reliability of utility service to CPS' customers in the event of the loss of the EMC.

Support Facilities

The operating systems are supported by modern shops for the maintenance of such items as meters, transformers, communication equipment, vehicles, railroad cars and heavy construction equipment. These shops, together with warehouses, supervisory offices, service centers and vehicle storage, are strategically located throughout the service area to minimize driving time to work locations.

General Offices and Customer Service Centers

The Main Office Complex makes up CPS' General Offices and is located at the intersection of Navarro and Villita Streets in downtown San Antonio. Executive, administrative, financial, information technology and engineering functions are located at this location. The Main Office Building is comprised of 11 floors of office space (with adjacent parking). The Navarro Office Building/garage facility provides three floors for office space and is connected to the Main Office Complex by an enclosed elevated walkway.

CPS' customer service center staff provides information concerning customer accounts and processes customer payments. Customer Service Centers and authorized pay agents are geographically located on the north, east, and west sectors of the service area. These centers are convenient to the customers' homes and in locations readily accessible to freeways. The Northside Customer Service Center serves as a customer service walk-in center, CPS customer call center, and additional general office space for personnel. The facility is an environmentally friendly facility utilizing various forms of renewable and alternative energy.

Construction Centers and Service Centers

CPS recently added one construction center. The primary function of this center is to pilot the newly redesigned new service delivery process which is limited to new construction. In addition, CPS maintains four construction centers, accommodating electric and gas construction, repair and maintenance services, support personnel for administration, planning, training, and warehousing functions and two service centers. The Salado Street Central Garage Service Center serves as the primary central garage for heavy equipment and vehicle repair and maintenance functions, with a separate building housing a central printing shop and warehousing.

Assembly Building

The Villita Assembly Building is located in downtown San Antonio near the Main Office Complex. The main hall has a capacity to accommodate 2,000 people as an auditorium or 1,200 for a dinner function. The building is used for CPS sponsored meetings and events and leased out to local civic, community, and non-profit organizations for major banquets, meetings and social events.

Vehicles and Work Equipment

CPS operates and maintains a fleet of automobiles, trucks, and heavy construction equipment. The garage facilities, located at CPS' service and construction centers are staffed with trained mechanics that provide a majority of the maintenance performed on the vehicles and equipment. Major maintenance on heavy construction equipment is performed at the Salado Street Central Garage Service Center.

SUMMARY OF INSURANCE PROGRAMS

CPS maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major financial risks. The property insurance program provides \$4.25 billion of replacement value for property and boiler, machinery loss coverage including comprehensive automobile coverage, fire damage coverage for construction equipment, and valuable papers coverage. The deductible for the property insurance policy is \$5.0 million per occurrence with a secondary deductible of \$1.0 million per occurrence applicable to non-power plant and non-substation property locations. The liability insurance program includes (1) general liability coverage, (2) workers compensation coverage, and (3) liability coverage and employment practice liability coverage. Other property and liability insurance coverage includes employee travel, event insurance, and commercial crime. CPS also maintains insurance reserves, which totaled \$8.6 million as of January 31, 2007, to cover losses under the self-insurance portion of the insurance program.

CPS and the other participants in STP maintain NRC-required nuclear liability, worker liability, and property insurance, each of which includes provisions for retrospective assessments depending on occurrences at STP and other commercial nuclear plants. CPS is liable for 40.0% of the premiums and any retrospective assessments with respect to STP insurance, and for costs of decontamination, repairs or replacement of damaged property in excess of policy limits; however, under PUCT regulations, AEP TCC's historical customers bear the risk associated with decommissioning that portion of STP previously owned by AEP TCC.

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ENVIRONMENTAL MATTERS

CPS operations have the potential to affect the environment in a variety of ways, including through discharges to the land, air and water. To minimize environmental impact, CPS constructs and operates its facilities according to the standards established for the utility industry by Federal, State, and local laws and regulations. CPS' commitment to the environment is evidenced by its official environmental policy, which places the responsibility for regulatory compliance on all CPS employees, regardless of job function or title. A full-time Environmental Department consisting of educated and trained professionals oversees the enforcement of this policy. Since 1996, over 100 environmental operating procedures ("EOPs") have been and continue to be developed to provide guidance to CPS employees as to how to perform their jobs in a way that protects the environment. Numerous courses are conducted to promote an understanding of how these EOPs apply to job functions.

Federal Clean Air Act

Congress enacted the Clean Air Act Amendments of 1990 ("Clean Air Act Amendments") with the intent of improving ambient air quality throughout the United States. All of CPS' generating units in Bexar County have been issued Federal Operating (Title V) permits and Federal Acid Rain (Title IV) permits under the Clean Air Act by the TCEQ.

Sulfur Dioxide: One objective of the Clean Air Act Amendments is to reduce emissions of sulfur dioxide ("SO₂"), a gaseous pollutant formed during the combustion of coal by coal-burning power plants. The J.K. Spruce Plant Unit 1 and the J.T. Deely Plant Unit 1 and Unit 2 became subject to the Clean Air Act Amendments' SO₂ emission allowance system. An "allowance" is an authorization to emit one ton of SO₂ during or after a specified year. Under the emission allowance system, each affected generating unit is issued annually a number of allowances, based upon a variety of factors. No utility may emit more tons of SO₂ in a year than is authorized by its total allowances. Allowances issued to one generating unit may be used by a utility to offset the emissions of another generating unit. Allowances not needed by the recipient utility for its current emissions may be banked for future use, or they may be sold or otherwise transferred to others. CPS plans to upgrade the scrubber prior to the JKS 2 unit coming on line because of a commitment made in the JKS 2 air permitting process which required JKS 1 to reduce SO₂ emissions by the amount expected to be emitted by JKS 2. A new EPA rule called the Clean Air Interstate Rule ("CAIR"), published in May of 2005, greatly reduces the number of allowances allocated to each utility starting in 2010 with further reductions by 2015. The rule will allow units to use sulfur dioxide allowances they have built up over the years at various ratios, which CPS feels would cover the Deely units' operation until scrubbers are installed there in the 2012 to 2013 time frame.

Nitrogen Oxides: In addition to SB 7 regulations that require NO_x reductions at CPS' formerly grandfathered gas units, TCEQ implemented additional rules called Chapter 117 regulations requiring all coal-fired power plants to achieve a NO_x emission level cap that was based on a NO_x emission rate of 0.165 lb/MMBtu by the year starting mid-2005 and all previously grandfathered gas-fired units to achieve a NO_x emission level cap that was based on a NO_x emissions rate of 0.14 lb/MMBtu. CPS met the limits for the calendar year 2006. The final CAIR reduces the NO_x emission rate to less than 0.15 lb/MMBtu in the first Phase and will be accomplished via statewide allocations that are required to be met in 2009 with further reductions by 2015. The new rule is a cap and trade rule which means that specific units are not required to meet any particular emission limit, only that they have adequate NO_x allowances for what they actually emit. CPS is undergoing careful study of the potential NO_x controls that may be required prior to CAIR becoming effective in 2009. CAIR has a limited provision for allowances for new units.

Mercury: In early 2004, EPA published a proposed rule to reduce mercury to a level of 21 X 10⁻⁶ lb/MWh from new units (about 2.0 lb/trillion Btu) and CPS agreed to this level for the new JKS 2 unit. The final rule was published in May 2005, called the Clean Air Mercury Rule, which established mercury emission limits on new and existing units and set up a cap-and-trade system starting in January 1, 2010. The final rule had a less stringent mercury limit for new units; however, CPS agreed to the previously proposed level and the final JKS 2 unit permit has a mercury limit (2.0 X 10⁻⁵ lb/MWh). The EPA goal is that emissions of mercury from power plants be reduced by 70.0% from today's levels and will result in a 15 ton cap nation-wide in 2018. The final rule also requires continuous mercury monitoring to be installed and operational by January 1, 2009.

Ozone: If a region of Texas has a level of ozone in the air that has surpassed a set level on multiple occasions during the year, the area is determined to be non-attainment for ozone, and the TCEQ must develop and implement a plan for the region as part of an EPA-approved State Implementation Plan. The EPA National Ambient Air Quality Standard for the San Antonio Metropolitan Area ("Area") for ozone is 0.08 parts per million ("ppm") averaged over an eight-hour period (instead of the previous one-hour standard of 0.12 ppm). Based on recent data, the Area has violated the eight-hour standard, causing the Area to be eligible to be designated as non-attainment for ozone. An Early Action Compact ("EAC")

was submitted to EPA by the Executive Committees of Alamo Area Council of Government as part of the Clean Air Plan for the four county Area including Bexar County. This effort allowed the Area to defer being declared non-attainment for the 8-hour ozone standard. In November 2006, the EPA officially deferred non-attainment for the four county Area until early 2008 pending outcome of the 2007 ozone season and the area must demonstrate compliance with the eight-hour ozone standard by December 31, 2007. Specific voluntary control strategies were implemented by December 31, 2005, and these control strategies were accepted by TCEQ and made part of the TCEQ's State Implementation Plan for ozone. Under the EAC, photochemical modeling is conducted, using proposed control strategies, to show achievement of the eight-hour standard by December 31, 2007. If the Area does not demonstrate compliance with the eight-hour ozone standard for ozone by the end of 2007 or fails to meet milestones in the EAC, the EPA will designate the Area as non-attainment for ozone. Should this happen, CPS power plants may be subject to increased NO_x reduction requirements, more than the CAIR limits, and have short-term NO_x limits imposed for the first time at some facilities. There will likely be increased restrictions on vehicle emissions and other small sources of NO_x, and volatile organic compounds such as painting activities and gasoline refueling. Designation of the Area as non-attainment by the EPA would also materially increase the cost of future CPS generation projects in the Area due to the imposition of tighter NO_x limits and the need to offset emissions of NO_x in the Area. The United States Supreme Court recently rendered its first major decision in the climate change arena. In *Massachusetts v. Environmental Protection Agency*, 549 U.S.____ (U.S. slip opinion released on April 2, 2007), the Supreme Court held that carbon dioxide and other greenhouse gases from motor vehicles are "air pollutants" subject to regulation under the Clean Air Act. At this time CPS cannot predict what legislation or administrative rules will be enacted by the EPA in response to this decision by the Supreme Court.

CPS, as one of the participants in the EAC, submitted a list of voluntary control strategies to help the Area achieve ozone attainment. These voluntary measures include planned reductions of NO_x emissions at CPS power plants, the purchase of alternative fueled vehicles, the continuation of CPS' "Mow Down Smog" program under which CPS provides rebates to purchasers of electric lawnmowers, and employee notifications of Air Quality Health Alert days.

Federal Clean Water Act

The National Pollutant Discharge Elimination System ("NPDES") program administered under the Federal Clean Water Act provides the framework for monitoring and regulating the discharge of any pollutant to surface waters of the United States. CPS has operated all of its generating facilities pursuant to water discharge permits from the State and NPDES permits from the EPA for many years with no significant compliance problems. The EPA delegated NPDES authority to the State, which implements a combined permit program on a "basin-wide" permitting basis.

Rulemaking by EPA concerning the Clean Water Act, Section 316(b) was designed to minimize the impact of power plant operations on fish. The rule may affect CPS' cooling lakes, Braunig and Calaveras. CPS will be required to meet the requirements of Section 316(b), which include requirements to reduce or minimize the impact of plant operations on fish in the lake. The specific ways CPS will comply with Section 316(b) are uncertain at this time because the rules are implemented by State regulatory agencies, which have discretion in compliance options. CPS utilizes treated sewage effluent and runoff waters rather than water from the Edwards Aquifer (the San Antonio area's primary source for potable water) to maintain operating levels at these man-made cooling lakes. For these water conservation efforts, the Association of Environmental Professionals selected CPS as one of eight 2001 recipients of the National Environmental Excellence Award.

Other Environmental Issues

By the early 1990's, CPS had completed a program aimed at removing from its system all electrical equipment accessible to the public that was known to contain polychlorinated biphenyls ("PCBs") in concentrations of 500 ppm or greater, as required by the Federal Toxic Substances Control Act. In addition, all oil-filled equipment is tested at the time of servicing as part of an ongoing program at CPS for voluntarily eliminating electrical equipment that contains mineral oil with any level of PCBs. Since 1996, in connection with capital improvements being made to many of its substation sites, CPS has identified and remediated areas found to be contaminated by pollutants, such as PCBs. The TCEQ allows the disposal of soil and debris contaminated with 1-49 ppm of PCBs from electrical equipment spills at a local landfill in lieu of distant disposal sites, at a considerable cost savings.

CPS also operates its own Class 1 non-hazardous waste landfill, which is registered with the TCEQ, an initiative that reduces disposal costs and CPS' reliance upon off-site disposal facilities. Since 1990, CPS has reduced the amount of hazardous waste (defined under the Federal Resource Conservation and Recovery Act) generated by its operations by about 90.0%.

CPS is currently planning to submit an air permit application to the TCEQ to construct new simple-cycle combustion turbines at the Braunig Lake site. These units will be similar to the peaking units at the Leon Creek plant with an estimated total capacity of approximately 200 MW. Based on current plans, these new units will use natural gas for fuel with back-up capacity to burn fuel oil. CPS plans to start construction on the new units in early 2008 and bring them in service in the summer of 2009.

CPS is scheduled to receive a Plantwide Applicability Limit ("PAL") permit soon for the Calaveras Lake plant facility. This PAL permit will set a cap on emissions at the site based on past emissions. This is a voluntary permit being submitted by CPS to provide flexibility to better manage facility-wide emissions. Once received, this PAL permit will allow CPS to have limited flexibility in maintaining its Calaveras Lake units while enhancing environmental protection. CPS' PAL permit application includes a commitment to maintain emission reductions that have been achieved in the past.

ENERGY CONSERVATION AND SAFETY PROGRAMS

CPS programs and activities to assist customers in understanding energy and ways to reduce electric and gas usage include:

- maintaining a special Energy Task Force telephone line where customers can obtain conservation and other energy-related information;
- conducting commercial energy audits;
- providing a \$15 coupon which can be redeemed for weatherization materials with each formal residential energy audit;
- continuing the "Cool Volunteers" program where CPS employees volunteer to weatherize more than 500 homes annually, as well as supporting other weatherization efforts throughout the community;
- assisting in calculating the size of residential air conditioning requirements;
- scheduling consumer information exhibits at high-traffic locations such as area shopping malls, trade shows, and other special events;
- conducting utility-related presentations for schools, community service organizations, and business and professional groups;
- mailing energy education materials and videos to schools upon request to supplement school curricula; and
- making available a residential self-energy audit video.

In connection with CPS' development of a Strategic Energy Plan, that includes energy efficiency as well as generation, CPS has developed a comprehensive, long-term energy efficiency plan. CPS will maintain, develop and implement programs and activities, alone and in collaboration with like-minded community entities, which will help achieve annual demand reduction targets that are indexed to the annual growth of electrical demand within the CPS service area. The goal is to achieve a peak demand reduction of 65 MW by January 31, 2016 through energy-efficiency programs. Current programs include Peak Saver, which cycles residential air conditioner compressors; residential rebates for both central air conditioners and window units; and commercial and industrial rebates for the installation of energy efficient air conditioners, motors, lighting, roof coatings and window film. CPS has committed to spend approximately \$30.0 million over five years to expand and enhance the long-term energy efficiency program with a peak demand impact goal of 10 MW in year five.

CPS' School Safety and Energy Education programs, which offer materials and services for students in kindergarten through the 12th grade, focus on timely topics such as the safe use of electricity and natural gas, energy conservation, utility careers, electric generation and transmission, and environmental issues. These materials and services can be used to supplement or update a school's current curriculum. Safety and energy education programs are available free of charge to all schools within the CPS service area. Consumer Relations representatives use a variety of videos, props, models, and other tools to illustrate the importance of safe and efficient use of electricity and natural gas. Teachers are provided with activity books to reinforce the message for follow-up lessons. Consumer Relations also maintains an energy education web portal at www.energywise.com, where educators, parents, and students can schedule programs and gain valuable information about gas and electricity.

The Public Safety Awareness Section ("PSA") provides electric and natural gas safety programs for all age groups. Since its inception in June 1986, the PSA has made 12,007 safety presentations to 1,976,953 contacts within the CPS service area and surrounding counties. During fiscal year 2006-07 the PSA provided 662 programs to 136,983 contacts. In addition to these public relation functions, the PSA works to provide natural gas incident programming with the affected public, government officials, emergency responders and excavators along CPS natural gas routes as required by the TRC and the Department of Transportation, Office of Pipeline Safety guidelines. The PSA works as a liaison with area educational, business, contractors, civic and emergency services organizations to establish strategic alliances that benefit the dissemination of CPS' natural gas and electric safety messages and enhance the utility's reputation as a good corporate citizen.

FUEL SUPPLY

CPS has a diversified generation fuel supply that includes coal, natural gas, nuclear, and fuel oil. CPS purchases natural gas for electric generation and local distribution through its natural gas system on a consolidated basis. Master enabling agreements with natural gas suppliers are reviewed on an ongoing basis to ensure adequate natural gas supplies exist to meet current and future requirements. While coal, natural gas, and nuclear fuel represent the base fuel supply for power generation, certain CPS power plants also have the capability to burn petroleum coke to supplement coal while others can burn fuel oil as an alternate fuel or to supplement natural gas. This dual fuel capability provides greater fuel flexibility. Fuel oil is used for start up and flame stabilization at the J.T. Deely Plant and can also be used for generation, when needed, at the O.W. Sommers and V.H. Braunig Plants.

Coal is CPS' base energy option, providing typically around 40% of its net annual generation. CPS' existing units and planned future unit are designed to use Wyoming Powder River Basin ("PRB") coal. PRB coal is clean, abundant and economical and it is part of CPS' long-range energy plan. Coal is secured through contracts providing both fixed and variable prices that reflect current market conditions. Delivery of PRB coal to CPS occurs on the Union Pacific ("UP") railroad with BNSF Railway having access rights to CPS' coal yard at Calaveras Lake. CPS has a favorable long-term contract with UP. Beginning the first calendar quarter of 2006, UP has improved its deliveries of PRB coal to CPS. While CPS will take every reasonable step to assure the continuity of its coal supply, CPS cannot predict whether any future coal shipment delays or curtailments could have a material adverse effect on the availability of its coal-fired generating stations.

Nuclear fuel procurement for STP is managed by the STP Nuclear Operating Company staff with oversight and guidance provided by the Participants. STP fuel supply requires uranium oxide, conversion of oxide to hexafluoride, enrichment of fissile uranium 235 isotope from 0.7% to about 4.5%, design and fabrication of fuel assemblies along with disposal of spent fuel assemblies. Uranium, conversion and enrichment are obtained under contracts of several years duration with primary producers. Beyond 2010, enrichment requirements are contracted with Urenco/LES, subject to NRC approval of Urenco/LES's license, through STP's current operating license term. Fabrication requirements are contracted with Westinghouse through STP's current operating license term. Spent fuel disposal is contracted with the DOE. Since the DOE has yet to open its spent fuel repository, the date by which it will start taking that fuel remains uncertain. The cost impact of continued storage of spent fuel on the STP site will remain uncertain until the date by which DOE will accept spent fuel has been established.

CPS also has high quality lignite reserves, including properties both owned and leased, in Lee and Bastrop Counties, Texas. CPS has leased these holdings for development and mining to the Aluminum Company of America, but retained ownership of the land, certain subsurface and other mineral rights, including an option to take lignite for its fuel needs. CPS has sold to SAWS certain water rights associated with these properties. On August 24, 2007 CPS sold all interests in the lignite properties.

CPS owns and operates natural gas transmission facilities, consisting of two larger systems and some short segments connected to power plants. The North Gate Pipeline and the South Gate Pipeline are the two larger systems. The North Gate Pipeline is a 24-inch steel pipeline, which extends 17.2 miles from southern Comal County into northern Bexar County, Texas. Natural gas can be supplied to the pipeline through the 36-inch Oasis Pipeline and the 30-inch West Texas Pipeline.

The South Gate Pipeline comprises 60.3 miles of 24 and 30-inch steel pipeline, of which 46.9 miles of 30-inch pipeline extends south into Karnes County. A major delivery station in Karnes County connects to the joint-venture pipeline owned by Kinder Morgan and AEP TCC. CPS also operates numerous taps throughout the system connecting to Enterprise Texas Pipeline, L.P. ("Enterprise"), previously GulfTerra Energy Partners, L.P., on the North Gate and South Gate Pipelines, and directly into the supply pressure and distribution systems. CPS utilizes its diverse natural gas supply portfolio and interconnects with various pipelines to meet its power plant and distribution requirements.

CPS manages combined natural gas supply requirements of the power plants and distribution systems through a diversified portfolio of firm and interruptible services with a variety of pipelines, storage operators and suppliers. In accordance with the CPS Fuels Management Procedures Policy, designated CPS staff may enter into natural gas supply transactions using master enabling agreements, which incorporate standard commercial terms. CPS has approximately 60 master enabling contracts with natural gas suppliers under which CPS may purchase its natural gas requirements. CPS manages firm transport and storage contracts with Enterprise. In June 2006 Enterprise reported significant deterioration of the storage and delivery capability of their storage caverns. Repairs were completed to one of the caverns, and as of May 2007 CPS has access to approximately 60% of its contract capacity. Most of the major natural gas delivery stations are owned by CPS and remotely monitored by the CPS control center, assuring reliable operation.

Periods of prolonged cold weather, during which natural gas supply may fall short of demand, may necessitate the curtailment of gas use for boiler fuel. The Natural Gas Policy Act subjects intrastate gas, including gas intended for boiler fuel use, to Presidential emergency purchase authority and emergency allocation authority to assist in meeting interstate natural gas requirements for high priority uses. CPS' gas supply has not been curtailed by its major suppliers since 1983. Nevertheless, CPS' gas supply is subject to the ability of its gas suppliers to acquire sufficient quantities of supply, as well as fluctuations in market prices.

CPS maintains fuel oil supplies at certain capable generating units. Depending on the unit, fuel oil may be used for startup, supplemental or primary fuel. CPS maintains inventory onsite and delivery capability at these plants to assure continued operation during natural gas supply disruptions or price events.

The Energy Price Risk Management Policy was implemented in 2002 to reduce the effects of energy price volatility consistent with this policy. At times, financial derivative instruments are utilized to hedge natural gas prices. See "WHOLESALE POWER MARKETING" and "RISK MANAGEMENT" herein.

On June 21, 2007, CPS entered into a prepaid natural gas transaction with SA Energy Acquisition Public Facility Corporation ("PFC"), a non-profit public facility corporation previously created by the City pursuant to Chapter 303, as amended, Texas Local Government Code. This transaction enabled CPS to purchase a 20 year supply of natural gas to cover approximately 20,000 MMBtu per day on an annual basis. This gas is dedicated for use in CPS' gas distribution system and CPS' obligation in this transaction is limited to a take-and-pay gas purchase agreement, obligating CPS to pay a monthly index-based price less a fixed discount for delivered gas. The PFC prepaid for this gas by issuing \$644,260,000 of tax-exempt fixed rate bonds and used the proceeds to make the payment to the natural gas supplier. This prepaid gas transaction was supported by its own official statement issued by the PFC fully disclosing the transaction and related risks.

POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS

The Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006, added section 4965 ("Section 4965") to the Internal Revenue Code, as amended ("Code"), which imposes an excise tax with respect to "prohibited tax shelter transactions" on certain "tax-exempt entities," including a state or political subdivision thereof, such as the City that is a "party to a prohibited tax shelter transaction". CPS, acting for the benefit of the City, entered into a series of leasing transactions ("Transactions") in 2000, which may be considered prohibited tax shelter transactions.

When initial guidance on Section 4965 was released, CPS calculated its potential tax liability under various scenarios. It determined, at least under one reading of the Code, that this liability could be as much as \$12 million for excise taxes in 2007. However, subsequent clarification of the regulations and rules implementing Section 4965 and additional guidance from the United States Department of the Treasury ("Treasury") may remove any going forward excise tax liability for CPS or the City.

The Internal Revenue Service ("IRS") published Notice 2007-18 on February 26, 2007 ("Notice") which, while it left many questions unanswered, provided certain interim guidance regarding the definition of the term "party to a prohibited tax shelter transaction" and the appropriate treatment of net income or proceeds received prior to the effective date of Section 4965. On July 6, 2007, the Treasury published Proposed Treasury Regulations, Temporary Treasury Regulations, and Temporary and Final Treasury Regulations interpreting Section 4965 and related Code sections (collectively, "New Regulations"). The New Regulations provide guidance that enables CPS to determine whether the City has Section 4965 tax liability related to the Transactions, including defining the terms "net income" and "proceeds," providing rules for proper allocation of net income and proceeds to periods before and after the effective date of Section 4965, exempting from Section 4965 excise taxes of net income and proceeds allocated to periods before the effective date of Section 4965, providing examples, and providing additional guidance regarding disclosure and filing requirements. CPS is in the process of determining whether, in light of this new guidance, it has any tax liability under Section 4965. Initial analysis of the New Regulations suggests that the City would not owe any excise taxes with respect to the Transactions and would not be required to file a tax return for fiscal year ending in 2007 or in subsequent years. Since the substantive rules of the New Regulations are contained in Proposed Treasury Regulations, the Treasury may make changes in the Final Treasury Regulations that adversely affect the liability of the City under Section 4965. CPS and its advisors will continue to analyze the New Regulations and any future guidance to assess the City's potential Section 4965 tax liability.

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LITIGATION

The City of San Antonio

This paragraph describes the litigation involving the City that does not directly involve CPS or claims payable out of Systems revenues, please see "LITIGATION – Systems Litigation and Claims" for a description of litigation involving CPS. The City is a defendant in various lawsuits and is aware of pending claims arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. That litigation includes lawsuits claiming damages that allege that the City caused personal injuries and wrongful deaths; class actions and promotional practices; various claims from contractors for additional amounts under construction contracts; and property tax assessments and various other liability claims, including workers' compensation claims and EEOC claims. The amount of damages in most of the pending lawsuits is capped under the Texas Tort Claims Act at \$250,000; therefore, the potential liability is approximated at \$12.6 million as of May 2, 2007. The amount of \$19.2 million is included as a component of the City's reserve for claims liability. The estimated liability, including an estimate of incurred but not reported claims, is recorded in the City's Insurance Reserve Fund. The status of such litigation ranges from early discovery stage to various levels of appeal of judgments both for and against the City. The City intends to defend vigorously against the lawsuits, including the pursuit of all appeals; however, no prediction can be made, as of the date hereof, with respect to the liability of the City for such claims or the outcome of such lawsuits.

In the opinion of the City Attorney, it is improbable that the lawsuits now outstanding against the City could become final in a timely manner so as to have a material adverse financial impact upon the City.

Systems Litigation and Claims

CPS is involved in various legal proceedings related to alleged personal and property damages, condemnation appeals, property tax assessments appeals, and discrimination cases. On August 25, 2006, CPS was sued by its former Senior Vice President and General Counsel for alleged violations of the Texas Whistleblower Act (including claims that certain City and CPS actions violated the Bond Ordinances), sex discrimination, and retaliation for reporting sex discrimination. CPS has entered into an agreement settling all claims asserted in this suit. CPS maintains a litigation reserve that is sufficient to satisfy this settlement and reasonable outcomes concerning all other pending litigation against CPS.

The City of San Antonio has delegated to the Systems the authority to condemn property in order to erect a 345Kv transmission line between the Cagnon and Kendall substations, a 138Kv line between the Texas Research and Medina Lake substations, together with a new substation, and a 138Kv line between the Cagnon and Lytle substations, together with a new substation ("Transmission Projects"). Certain landowners with easements along the routes for these Transmission Projects have brought suit to determine the value of property easements being acquired through condemnation. In the aggregate, the cost of these property easements could be as much as several million dollars. Since the reasonable costs associated with acquisition of property for the Transmission Projects may be eventually recovered from ERCOT ratepayers through transmission cost of service proceedings, see "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation" herein, CPS has not made an adjustment in its litigation reserve to address the potential liabilities associated with the Transmission Projects.

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WHOLESALE POWER MARKETING

Beginning in 1997, CPS initiated an active program to market its excess generation capacity in the wholesale power market. CPS' power marketing strategy also includes purchasing power if the cost of such power is below what it would cost for CPS to supply the energy from its own generation units. CPS may also purchase power if there is an unanticipated deficit in capacity, to maintain planning reserve margins, or to enhance reliability for the electric system. CPS buys power only for CPS customer load requirements and does not sell power in excess of its available generation capacity. CPS' sales and purchase volumes represent less than 10% of CPS' generation volumes.

Trained, experienced staff in CPS' Wholesale Energy Markets Division, who report to the CPS Executive Vice President for Energy Development, conduct wholesale power marketing transactions. Any deviation from current operating procedures related to purchases or sales of energy must be reported to management and, depending on the deviation, also to the Board.

CPS conducts wholesale power marketing transactions only with approved counterparties with which CPS has established master Enabling Agreements for such transactions. The enabling agreements outline the general payment and delivery terms and conditions of such sales and purchases, and provide for written transaction confirmations to be exchanged between CPS and its counterparts for each transaction.

RISK MANAGEMENT

In June 1998, CPS established a Risk Management Department under the direction of the Executive Vice President and Chief Financial Officer. The Risk Management Department works closely with the Wholesale Energy Markets staff and provides credit risk assessments of existing and potential counterparties. Capabilities in this area have continued to expand. In April 2006, a Chief Risk Officer was brought on board to monitor financial and other risks for CPS, and the department was renamed Enterprise Risk Management.

As part of its risk management and fuel and electricity purchasing policies, CPS has the capability to utilize certain derivative financial instruments, such as energy-based futures, options and swap contracts to hedge or mitigate price volatility associated with fuel and energy sales and purchases. The program is operated in accordance with a written policy approved by the Board. A program oversight committee composed of CPS corporate officers and senior executives approves operating policies and corporate hedging strategies.

INVESTMENTS

Operating Funds

CPS invests its operating funds as authorized by its bond and commercial paper ordinances and by federal and Texas law including, but not limited to, the Public Funds Investment Act, as amended, Chapter 2256, Texas Government Code ("Investment Act"), Chapter 272, as amended, Texas Local Government Code, and in accordance with written investment policies approved by the Board. These ordinances, laws and CPS' investment policies are subject to change.

Under current Texas law and the investment policies approved by the Board, CPS may invest its funds in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued by a Federal agency or instrumentality of the United States; (4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by Texas or the United States or their agencies and instrumentalities; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated not less than "A" or its equivalent; (6) a certificate of deposit or share certificate which is fully secured and/or federally insured; (7) securities lending programs that are 100-102% collateralized; (8) fully collateralized repurchase agreements; (9) certain bankers' acceptances; (10) commercial paper rated not less than "A-1" or "P-1" or equivalent and that have a stated maturity of 270 days or fewer from the date of issuance; (11) no-load money market mutual funds that have a dollar weighted average stated maturity of 90 days or less; and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share; (12) certain no-load mutual funds that are rated at least "AAA" or its equivalent; (13) certain guaranteed investment contracts that are funded by bond proceeds if authorized in the order, ordinance, or resolution authorizing the issuance of the bonds; (14) investment pools that stabilize at a \$1 net asset value to the extent reasonably possible and are rated no lower "AAA" or "AAA-m" or equivalent; (15) in connection with a transaction authorized by Section 272.004 of the Local Government Code, one or more of the investments, securities, guarantees, and/or insurance contracts or other contracts and agreements described in Section 452.108(d) of the Texas Transportation Code, including, but not limited to the following:

payment agreements, financial guarantees or insurance contracts with counterparties having either a corporate credit or debt rating in any form, a claims-paying ability, or a rating for financial strength of "AA" or better and (16) hedging instruments authorized by Section 2256.0201 of the Texas Government Code and in accordance with CPS' Energy Price Risk Management Policy for the purpose of managing risks of financial uncertainty or loss associated with adverse volatility in the pricing of CPS' energy and fuel assets, to include energy based futures contracts, option contracts, swap contracts, insurance contracts, and structured contracts composed of combinations of hedging instruments.

CPS is specifically prohibited from investing its funds in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the change in the market index.

The weighted term to maturity of investments at January 31, 2007 was 141 days for operating and construction funds. CPS' operating and construction funds, as of January 31, 2007, were invested entirely in United States Government or Government Agency Obligations held in book-entry form by the Federal Reserve, in money market mutual funds, or in money market deposit accounts. Investments at amortized cost were \$1.190 billion and at market value were \$1.190 billion at January 31, 2007. Based on principal cost, 96% are invested in United States Government Agency Obligations, and 4% in money market mutual funds, and in money market deposit accounts. CPS determines the market value of such investments by reference to published quotations, dealer bids, and comparable information. No CPS funds are invested currently in reverse repurchase agreements or derivative securities, securities whose rate of return is determined by reference to some other instrument, index, or commodity, except for certain natural gas options held under the Energy Price Risk Management Policy. See "WHOLESALE POWER MARKETING", "RISK MANAGEMENT" and "FUEL SUPPLY".

STP Decommissioning Funds

CPS invests the funds in two specific decommissioning trusts, the STP Decommissioning Trust and the Master Trust (TCC Funded), in accordance with its decommissioning investment policy and as authorized by Texas law, the NRC and, where applicable, the PUCT. The STP Decommissioning Trust is the sinking fund created by CPS for the sole purpose of financing the decommissioning expenses for its original interest in STP. CPS obtained the Master Trust (TCC Funded) after it purchased from AEP Texas Central Company, an additional interest in STP. As part of the acquisition of the additional interest in STP, CPS obtained a proportionate amount of the nuclear decommissioning trust fund originally created by TCC. Responsibility for continuous funding of the Master Trust (TCC Funded) will remain the responsibility of TCC customers through final decommissioning of STP. At acquisition by CPS of the additional interest in STP from TCC, the funds were transferred to CPS by TCC and placed into the Master Trust (TCC Funded), which is entirely separate from the existing decommissioning trust fund held in the STP Decommissioning Trust created and maintained by CPS for its original interest in STP. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - South Texas Project" for further discussion of CPS' acquisition of a 12% interest in STP from TCC. CPS' investments in the STP Decommissioning Trust and in the Master Trust (TCC Funded) are held by an independent trustee and are invested pursuant to a separate investment policy adopted by the Board and to the provisions of the trust agreements of each trust.

Effective September 1, 2005, the Investment Act was amended to allow a Texas municipality which owns a municipal electric utility to invest its decommissioning trust funds in any investment authorized by Subtitle B, Title 9 of the Texas Property Code. The broad investment authority found in the Texas Property Code includes, but is not limited to, the authority to invest in equities.

Under the Property Code, other applicable law and the South Texas Project Decommissioning Trust Investment Policy ("STP Investment Policy") approved by the Board, the STP Decommissioning Trust may be invested as follows: (1) funds may be invested in investments permissible by law under the guidance and regulations issued by the NRC and under the Texas Property Code; (2) the STP Decommissioning Trust's investments should be diversified such that (a) no more than 5.0% of the securities held may be issued by one entity, with the exception of the federal government, its agencies and instrumentalities, and (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investment trusts diversified as to geographic region; (3) derivative securities are limited to those whose purpose is to enhance returns of the STP Decommissioning Trust without a corresponding increase in risk of the portfolio; (4) securities lending transactions must be collateralized at 100-102%; (5) fixed income securities may not be rated below "BBB-" by Standard & Poor's Ratings Services ("S&P") and Fitch Ratings or "Baa3" by Moody's Investors Service, Inc. ("Moody's"), at the time of purchase, and the overall fixed income portfolio must be rated no less than "A" by, S&P, Fitch Ratings and Moody's; (6) equity securities are permissible investments (a) limited to a cap of (i) 60% when the weighted

average remaining life of the decommissioning liability exceeds 5 years, (ii) 30% when the weighted average remaining life of decommissioning liability ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) when the equities are of a type not considered to be speculative; and (7) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds are permissible investments, if the commingled funds are consistent with the goals stated in the STP Investment Policy. Commingled funds (a) may be focused on specific market sectors or concentrated in a few holdings only as necessary to balance the trust's overall investment portfolio mix, and (b) may contain some below investment grade bonds; but the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below an "A" rating by S&P or an "A" by Moody's.

The STP Decommissioning Trust is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal debt securities that have a bond rating below investment grade (below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade after the debt security has been purchased; and (4) from investing in equity securities that are considered speculative (e.g., stocks of companies with limited operating history or that have low "safety" rankings from ratings agencies).

Investments in the STP Decommissioning Trust consisted of fixed income securities, equity securities and cash equivalents at January 31, 2007. The total market value of all investments was \$254.9 million. Fixed income securities totaled \$117.4 million and had an average duration to maturity of 4.48 years. Based upon market value, the fixed income securities were 65% United States Government and Government Agency Obligations, and 35% Corporate and Municipal Bonds. Equity securities had a market value of \$127.6 million. The remaining \$9.9 million of market value was held in cash, cash equivalents, collateral and accrued income.

Master Trust (TCC Funded)

Under applicable law, including NRC and PUCT regulations, and the STP Investment Policy, the Master Trust (TCC Funded), may be invested in (1) a way that, once the portfolio of securities (including commingled funds) held in the Trust contains securities with an aggregate value in excess of \$20 million, the funds are diversified so that (a) no more than 5.0% of the Investment Manager's portfolio of securities held are issued by one entity, with the exception of the federal government, its agencies and instrumentalities, (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investments diversified as to geographic region; (2) derivative securities limited to those whose purpose is to enhance returns of the trust without a corresponding increase in risk of the portfolio; (3) securities lending transactions when collateralized at 100-102%; (4) fixed income securities not rated below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's, at the time of purchase; (5) equity securities, (a) limited to a cap of (i) 60.0% when the weighted average remaining life of the decommissioning liability exceeds 5 years, (ii) 30.0% when the weighted average remaining life ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0.0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) with at least 70.0% of the aggregate market value of the equity portfolio, including the individual securities in commingled funds, having a quality ranking from a major rating service and the overall portfolio of ranked equities with a weighted average quality rating equivalent to the composite rating of the S&P 500 index assuming equal weighting of each ranked security in the index; and (6) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds that (a) are consistent with the goals stated in the investment policy, (b) are focused on specific market sectors or concentrated in a few holdings only if used as necessary to balance the trust's overall investment portfolio mix, and (c) may contain some below investment grade bonds; however, the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below a "AA" rating by S&P or "Aa2" by Moody's.

The Master Trust (TCC Funded) is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal debt securities that have a bond rating below investment grade (below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade at some time after the debt security has been purchased; (4) from investing in equity securities where the issuer has a capitalization of less than \$100 million; and (5) from investing in securities issued by the electric utility collecting the funds or any of its affiliates; however, investments may include commingled funds that contain securities issued by the electric utility if the

securities of the utility constitute no more than 5.0% of the fair market value of the assets of such commingled funds at the time of the investment.

At January 31, 2007, CPS' investments in the Master Trust (TCC Funded) consisted of fixed income securities, equity securities and cash equivalents with a total market value of \$82.2 million. The fixed income securities totaled \$31.7 million with an average duration to maturity of 4.6 years. Based upon market values, 70% of these fixed income securities were invested in United States Government and Government Agency obligations, 14% in Municipal Bonds, and 16% in Corporate Bonds. Investment in equity securities represented a market value of \$50.1 million. The remaining \$0.4 million in market value consisted on Cash, Cash Equivalents and accrued income.

Investment Policies

Under the Investment Act, CPS is required to invest its funds in accordance with written investment policies that (1) primarily emphasize safety of principal and liquidity; (2) address investment diversification, yield, maturity, and the quality and capability of investment management; (3) include a list of authorized investments for CPS funds and the maximum allowable stated maturity of any individual investment; (4) state the maximum average dollar-weighted maturity allowed for pool fund groups; (5) contain the methods to monitor the market price of investments acquired with public funds; and (6) require the settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis. All CPS funds must be invested consistent with formally adopted written investment strategies that specifically address each fund's investment. Each strategy describes its objectives concerning (1) suitability of investment type; (2) preservation and safety of principal; (3) liquidity; (4) marketability of each investment; (5) diversification of the portfolio; and (6) yield.

Under the Investment Act, CPS investments under all investment policies must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived."

Consistent with the requirements of the NRC, Texas Property Code, the Investment Act, and as applicable, the PUCT, the STP Decommissioning Trust, and the Master Trust (TCC Funded) will be invested consistent with the following goals: (1) the funds will be invested with a goal of earning a reasonable return commensurate with the need to preserve the value of the assets; (2) the portfolio of securities will be diversified to the extent reasonably feasible given the size of the trust; (3) asset allocation and the acceptable risk level of the portfolio will take into account market conditions, the time horizon remaining before the commencement and completion of decommissioning, and the funding status of the trust; (4) while maintaining an acceptable risk level, the investment emphasis when the remaining life of the liability exceeds five years will be to maximize net long-term earnings and the investment emphasis in the remaining investment period of the trust will be on current income and asset preservation; and (5) in selecting investments, the impact of the investment on the portfolio's volatility and expected return net of fees will be considered.

Additional Provisions

Under the Investment Act for the Operating Funds, STP Decommissioning Trust and the Master Trust (TCC Funded), CPS must: (1) review annually and, if desired, change its adopted written investment policies and strategies; (2) designate investment officers to be responsible for investment of its funds consistent with the investment policies of CPS; (3) require any investment officers with personal business relationships or relatives with firms seeking to sell securities to the entity to disclose the relationship and file a statement with the Texas Ethics Commission and the Board; (4) require the qualified representative of firms seeking to sell securities to CPS to (a) receive and review the CPS investment policies; (b) acknowledge that reasonable controls and procedures have been implemented to preclude investment transactions not authorized by the CPS investment policies; and (c) deliver a written statement attesting to these requirements; (5) perform an annual audit of the management controls on investments and adherence to the CPS investment policies; (6) provide specific investment training for CPS' investment officers; and (7) review, revise, and adopt on an annual basis a list of qualified brokers that are authorized to engage in investment transactions with CPS.

For the STP Decommissioning Trust and the Master Trust (TCC Funded), CPS is prohibited from being engaged as investment manager for the funds or from giving day-to-day management direction of the funds' investments. Therefore, the use of one or more professional investment managers is necessary to assure that the trusts are managed in a manner so that the funds are secure and earn a reasonable return. CPS has the following duties concerning the use of one or more investment managers: (1) a duty to determine whether the investment manager's fee schedule for investment management services is reasonable, when compared to other such managers; (2) a duty to investigate and determine whether the past

performance of the investment manager in managing investments has been reasonable; (3) a duty to investigate and determine whether the financial stability and strength of the investment manager is adequate for purposes of liability; (4) a duty to investigate and determine whether the investment manager has complied with the investment management agreement; and (5) a duty to investigate any other factors which may bear on whether the investment manager is suitable.

Some of the proceeds of the financial lease/leaseback transaction with a subsidiary of Unicom Corporation involving CPS' J.K. Spruce Unit 1 are invested, as security for certain CPS undertakings in connection with the transaction, in a collateralized payment undertaking agreement among (1) CPS; (2) Spruce Equity Holdings, L.P., a Delaware limited partnership; (3) Spruce Holdings Trust, a Delaware business trust; and (4) a subsidiary of American International Group, Inc. Unicom Corporation, subsequent to this transaction, has merged into Exelon Corporation. See "POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS" herein.

CONTINUING DISCLOSURE OF INFORMATION

In the Ordinance, the City and the Board made the agreement described below for the benefit of the holders and Beneficial Owners of the Bonds. The City and the Board are required to observe the agreement for so long as they remain obligated to advance funds to pay the Bonds. Under the agreement, the City and the Board will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to certain information vendors. This information will be available to securities brokers and others who subscribe to receive the information from the vendors.

Annual Reports

Under Texas law, including, but not limited to, Chapter 103, as amended, Texas Local Government Code, Texas Government Code Sections 1502.66, 1502.67 and 1502.68, as amended, and the City's Home Rule Charter, the City and the Board must keep their fiscal records in accordance with generally accepted accounting principles, must have their financial accounts and records audited by an independent certified public accountant, and must file each audit report with the City Clerk or the Secretary of the Board, as appropriate, within 120 days after the close of the City's or Board's fiscal year. The City's fiscal records and audit reports are available for public inspection during the regular business hours of the City Clerk. The Board's financial statements and independent auditors' reports are available for public inspection to the extent information contained in them is not excepted from disclosure under the Texas Public Information Act, as amended, Texas Government Code, Chapter 552. Persons may obtain copies of the portions of these documents not excepted from disclosure under the Texas Public Information Act upon submission of a written request to the City Clerk or Secretary of the Board, as appropriate, and paying the reasonable copying, handling and delivery charges for providing this information.

The Ordinance obligates the Board to provide certain updated financial information and operating data to certain information vendors annually. The information to be updated includes all quantitative financial information and operating data with respect to the Board of the general type included in this Official Statement under the headings "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Customer Base"; "TEN-YEAR ELECTRIC CUSTOMER STATISTICS"; "FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY"; "FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE"; "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Generating Capability"; "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Five-Year South Texas Project Capacity Factor"; "DESCRIPTION OF PHYSICAL PROPERTY – OTHER ELECTRIC AND GAS SYSTEMS STATISTICS"; and APPENDIX B. The Board will update and provide this information within six months after the end of each fiscal year. The Board will provide the updated information to certain information vendors.

The Board may provide updated information in full text or may incorporate by reference certain other publicly available documents, as permitted by the United States Securities and Exchange Commission ("SEC") Rule 15c2-12 ("Rule"). The updated information will include audited financial statements, if the Board commissions an audit and it is completed by the required time. If audited financial statements are not available by the required time, the Board will provide audited financial statements when the audit report becomes available. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B, or such other accounting principles as the Board may be required to employ from time to time pursuant to Texas law or regulation.

Material Event Notices

The Board will also provide timely notices of certain events to certain information vendors. The Board will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (7) modifications to rights of holders of the Bonds; (8) Bond calls; (9) Bond defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. Neither the Bonds nor the Ordinance make any provision for credit enhancement. In addition, the Board will provide timely notice of any failure by the Board to provide information, data, or financial statements in accordance with its agreement described above under "Annual Reports". The Board will provide each notice described in this paragraph to any SID and to either each NRMSIR or the MSRB.

Availability of Information from NRMSIRs and SID

The Board has agreed to provide the foregoing information only to NRMSIRs and any SID. The information will be available to holders of Bonds only if the holders comply with the procedures and pay the charges established by such information vendors or obtain the information through securities brokers who do so.

The Municipal Advisory Council of Texas ("MAC") has been designated by the State and approved by the SEC staff as a qualified SID. The address of the MAC is 600 West 8th Street, Post Office Box 2177, Austin, Texas 78768-2177, and its telephone number is (512) 476-6947. The MAC has also received SEC approval to operate, and has begun to operate, a "central post office" for information filings made by municipal issuers, such as the City. A municipal issuer may submit its information filings with the central post office, which then transmits such information to the NRMSIRs and the appropriate SID for filing. This central post office can be accessed and utilized at www.DisclosureUSA.org ("DisclosureUSA"). The Board utilizes DisclosureUSA for the filing of information relating to the Bonds.

Limitations and Amendments

The Board has agreed to update information and to provide notices of material events only as described above. The Board has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, conditions, or prospects or agreed to update any information that is provided, except as described above. The Board makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The Board disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders and Beneficial Owners of Bonds may seek a writ of mandamus to compel the Board to comply with its agreement.

The Board may amend its continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the Board, if the agreement, as amended, would have permitted an underwriter to purchase or sell the Bonds in the offering described herein in compliance with the Rule and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or any person unaffiliated with the Board (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the Beneficial Owners of the Bonds. The Board may also repeal or amend the provisions of its continuing disclosure agreement if the SEC amends or repeals the applicable provisions of the Rule or any court of final jurisdiction enters judgment that such provisions of the Rule are invalid, and the Board also may amend these provisions in its discretion in any other manner or circumstance, but in either case, only if and to the extent that the provisions of this sentence would not have prevented an underwriter from lawfully purchasing or selling Bonds in the primary offering of bonds, giving effect to (a) such provisions as so amended and (b) any amendments or interpretations of the Rule. If the Board amends its agreement, it must include with the next financial information and operating data provided in accordance with its agreement described above under "Annual Reports" an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided.

Compliance with Prior Undertakings

During the last five years, the City and the Board have complied in all material respects with all continuing disclosure agreements made by them in accordance with the Rule.

LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale of the Bonds were subject to the unqualified approval of the Attorney General of the State of Texas and the approval of certain legal matters by Co-Bond Counsel. Co-Bond Counsel was engaged by the Board and only represented the Board and the City. Co-Bond Counsel were not requested to participate and did not take part in the preparation of this Official Statement except as hereinafter noted, and such firms did not assume any responsibility with respect thereto or undertaken independently to verify any of the information contained herein, except that, in their capacity as Co-Bond Counsel, such firms reviewed the information under the captions "THE BONDS" (except under the sub-captions "Sources and Uses of the Bond Proceeds", "Perfection of Security for the Bonds", "Registered Owners' Remedies", and "Book-Entry-Only System", as to which no opinion was expressed) and "CONTINUING DISCLOSURE OF INFORMATION" (except matters discussed under the subcaption "Compliance with Prior Undertakings", as to which no opinion was expressed), "LEGAL MATTERS" (except for the last sentence of the first paragraph as to which no opinion was expressed), "TAX MATTERS", "LEGAL INVESTMENTS IN TEXAS", "SECURITIES LAWS", "APPENDIX C – CERTAIN PROVISIONS OF THE ORDINANCE", and "APPENDIX D – FORM OF OPINION OF CO-BOND COUNSEL" in this Official Statement, and such firms were of the opinion that the information relating to the Bonds, the Ordinance and the legal issues contained under such captions and sub-captions were an accurate and fair description of the laws and the legal issues addressed therein and, with respect to the Bonds, such information conformed to the Ordinance. The legal fees paid to Co-Bond Counsel in connection with the issuance of the Bonds were contingent on the sale and delivery of the Bonds. Certain legal matters were passed upon for the Underwriters by their counsel, McCall, Parkhurst & Horton L.L.P., Dallas, Texas, whose legal fees were contingent on the sale and delivery of the Bonds, and for CPS by its General Counsel and for the City by the City Attorney.

The various legal opinions that were delivered concurrently with the delivery of the Bonds expressed the professional judgment of the attorneys rendering the opinions as to these legal issues explicitly addressed therein. In rendering legal opinions, the attorney did not become an insurer or guarantor of the expression of professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction, nor did the rendering of these opinions guarantee the outcome of any legal dispute that may arise out of the transaction.

TAX MATTERS

Tax Exemption

Co-Bond Counsel stated in an opinion ("Original Opinion") dated May 15, 2003, that, as of such date, interest on the Bonds for federal income tax purposes (1) would be excludable from gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date of such opinion ("Code"), pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) would not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The form of Co-Bond Counsel's opinion ("Original Opinion") is reproduced as Appendix D. The statutes, regulations, rulings, and court decisions on which such opinion was based are subject to change.

The Original Opinion noted that interest on all tax-exempt obligations, including the Bonds, owned by a corporation would be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate investment trust, a real estate mortgage investment conduit, or a financial asset securitization investment trust ("FASIT"). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code will be computed.

Accordingly, Co-Bond Counsel's Original Opinion assumed continued compliance with covenants contained in the Ordinance related to exclusion from gross income interest on the Bonds for federal income tax purposes and relied upon representations and certifications of the City made in the certificate dated the date of initial delivery of the Bonds pertaining to the use, expenditure, investment of the proceeds of the Bonds. If the City failed or fails to comply with the covenants in the Ordinance or if the foregoing representations should be determined to be inaccurate or incomplete, interest on the Bonds may become taxable from the date of initial delivery of the Bonds, regardless of the date on which the event causing such taxability occurs.

Co-Bond Counsel has not been asked to undertake and is not undertaking any review or investigation of and has not been asked to express and does not express any opinion concerning the continuing treatment of the interest on the Bonds as excludable from gross income for federal income tax purposes.

In the Original Opinion, Co-Bond Counsel expressed no other opinion with respect to any other federal, state or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a financial asset securitization investment trust, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Co-Bond Counsel has not expressed any opinion as to the treatment for federal income tax purposes of the interest paid by any liquidity provider for the Bonds or the effect on the excludability from gross income for federal income tax purposes of any action taken under the Ordinance which requires that the City shall have received an opinion of counsel nationally recognized in the field of municipal finance to the effect that such action will not adversely affect the excludability of the interest on the Bonds from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes. The Ordinance provides that prior to taking certain actions, including converting the interest rate on the Bonds from one rate mode to another rate mode, the City must have received such an opinion.

Co-Bond Counsel's Original Opinion was not a guarantee of a result, but represented its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the City described above. No ruling was sought from the Internal Revenue Service ("Service") with respect to the matters addressed in the Original Opinion and Co-Bond Counsel's Original Opinion is not binding on the Service. The Service has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Bonds is commenced, under current procedures the Service is likely to treat the Issuer as the "taxpayer," and the owners of the Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Bonds, the City may have different or conflicting interests from the owners of the Bonds. Public awareness of any audit of the Bonds could adversely affect the value and liquidity of the Bonds during the pendency of the audit, regardless of its ultimate outcome.

LEGAL INVESTMENTS IN TEXAS

Section 1201.041 of the Public Securities Procedures Act (Chapter 1201, as amended, Texas Government Code) provides that the Bonds are negotiable instruments governed by Chapter 8, Texas Business and Commerce Code, and are legal and authorized investments for insurance companies, fiduciaries, and trustees, and for the sinking funds of municipalities or other political subdivisions or public agencies of the State of Texas. With respect to investment in the Bonds by municipalities or other political subdivisions or public agencies of the State of Texas, the Public Funds Investment Act, as amended Chapter 2256, Texas Government Code, requires that the Bonds be assigned a rating of at least "A" or its equivalent as to investment quality by a national rating agency. See "RATINGS". In addition, various provisions of the Texas Finance Code provide that, subject to a prudent investor standard, the Bonds are legal investments for state banks, savings banks, trust companies with at least one million dollars of capital, and savings and loan associations. The Bonds are eligible to secure deposits of any public funds of the State, its agencies, and its political subdivisions, and are legal security for those deposits to the extent of their market value.

The City has made no investigation of other laws, rules, regulations or investment criteria which might apply to such institutions or entities or which might limit the suitability of the Bonds for any of the foregoing purposes or limit the authority of such institutions or entities to purchase or invest in the Bonds for such purposes. The City has made no review of laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

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SECURITIES LAWS

No registration statement relating to the Bonds has been filed with the SEC under the Securities Act of 1933, as amended, in reliance upon exemptions provided thereunder. The Bonds have not been registered or qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been registered or qualified under the securities laws of any other jurisdiction. The City assumes no responsibility for registration or qualification of the Bonds under the securities laws of any such jurisdiction in which the Bonds may be offered, sold or otherwise transferred. This disclaimer of responsibility for registration or qualification for sale or other disposition of the Bonds must not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration or qualification provisions in such other jurisdictions.

RATINGS

Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Rating Services, a Division of The McGraw-Hill Companies Inc. ("S&P") have each reaffirmed the long-term and short-term ratings of "AA+" / "F1+", "Aa1", and "AA", respectively, to the Bonds. An explanation of the significance of such ratings may be obtained from Fitch, Moody's and S&P. The rating of the Bonds by Fitch, Moody's and S&P reflects only the view of said company at the time the rating is given, and the City makes no representations as to the appropriateness of the rating. There is no assurance that the rating will continue for any given period of time, or that the rating will not be revised downward or withdrawn entirely by Fitch, Moody's and S&P in the judgment of Fitch, Moody's and S&P as circumstances so warrant. Any such downward revision or withdrawal of the rating may have an adverse effect on the market price of the Bonds.

CO-FINANCIAL ADVISORS

First Southwest Company and Estrada Hinojosa & Company, Inc. ("Co-Financial Advisors") are employed as Co-Financial Advisors to the Board in connection with the issuance and remarketing of the Bonds. The Co-Financial Advisors' fee for services rendered with respect to the initial issuance or remarketing of the Bonds is contingent upon the issuance, remarketing and delivery of the Bonds. Although the Co-Financial Advisors have read and participated in the preparation of this Official Statement, they have not independently verified any of the information set forth herein. The information contained in this Official Statement has been obtained primarily from the City's and the Board's records and other sources which are believed to be reliable, including financial records of the Board and other entities, which may be subject to interpretation. No person, therefore, is entitled to rely upon the participation of the Co-Financial Advisors as implicit or explicit expression of opinions as to the completeness and accuracy of the information contained in this Official Statement. The Co-Financial Advisors have relied on the opinions of Co-Bond Counsel and have not verified and do not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

INDEPENDENT AUDITORS

This Official Statement includes the audited financial statements of CPS for the fiscal years ended January 31, 2006 and 2007. These financial statements included in this Official Statement as APPENDIX B have been audited by KPMG LLP, Garza, Preis & Co., L.L.C., and Robert J. Williams, CPA, independent accountants, as stated in their report thereon, which includes a reference to other auditors, which also appears in APPENDIX B hereto.

USE OF INFORMATION IN OFFICIAL STATEMENT

No person has been authorized to give any information or to make any representations other than those contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the City or the Board. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy in any state in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer of solicitation.

MISCELLANEOUS

The description of the Bonds contained in this Official Statement does not purport to be complete. All references to the Bonds are qualified by reference to the Ordinance and to the complete form of the Bonds. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and resolutions contained in this Official Statement are made subject to all of the provisions of such statutes, documents and resolutions. These summaries do not purport to be complete statements of such provisions and reference is made to such documents for further information. Reference is made to original documents in all respects. So far as any statements made in this document involve budgeted amounts or other estimates or projections, whether or not so expressly stated, they should not be considered statements of fact or representations that the budgeted amount, estimate or projection will approximate actual results.

This Official Statement has been approved by the City Council and the Board.

CITY OF SAN ANTONIO, TEXAS

CITY PUBLIC SERVICE BOARD OF SAN ANTONIO

By /s/ Phil Hardberger
Mayor, City of San Antonio, Texas

By /s/ Stephen S. Hennigan
Chairman, Board of Trustees
City Public Service Board of San Antonio

APPENDIX A



CITY OF SAN ANTONIO, TEXAS

GENERAL DEMOGRAPHIC AND ECONOMIC INFORMATION

APPENDIX A

CITY OF SAN ANTONIO

GENERAL DEMOGRAPHIC AND ECONOMIC INFORMATION

This Appendix contains a brief discussion of certain economic and demographic characteristics of the City of San Antonio, Texas (the "City" or "San Antonio") and of the metropolitan area in which the City is located. Although the information in this Appendix has been provided by sources believed to be reliable, no investigation has been made by the City to verify the accuracy or completeness of such information.

Population and Location

The Census 2000, prepared by the U.S. Census Bureau, found a City population of 1,144,646. The City's Department of Planning estimated the City's population at 1,320,100 for the calendar year ending March 1, 2007. The U.S. Census Bureau ranks the City as the second largest in the State of Texas and the seventh largest in the United States.

The City is the county seat of Bexar County, which had a population of 1,392,931 according to the Census 2000. The City's Department of Planning estimated Bexar County's population at 1,610,900 for the calendar year ending March 1, 2007. The City is located in south central Texas approximately 75 miles south of the state capital in Austin, 140 miles northwest of the Gulf of Mexico, and approximately 150 miles from the U.S./Mexico border cities of Del Rio, Eagle Pass, and Laredo, respectively.

The following table provides, as of April 1 for the years shown, the population of the City, Bexar County, and the San Antonio Metropolitan Statistical Area ("MSA")¹:

Year	City of San Antonio	Bexar County	San Antonio MSA
1920	161,379	202,096	238,639
1930	231,543	292,533	333,442
1940	253,854	338,176	376,093
1950	408,442	500,460	542,209
1960	587,718	687,151	736,066
1970	654,153	830,460	888,179
1980	786,023	988,971	1,088,881
1990	935,933	1,185,394	1,324,749
2000	1,144,646	1,392,931	1,711,703 ¹

¹ As of June 2003, the United States Office of Management and Budget redefined the San Antonio MSA by increasing the number of counties from four to eight: Atascosa, Bandera, Kendall, and Medina Counties were added to its mainstays of Bexar, Comal, Guadalupe, and Wilson Counties. (The 2000 figure reflects the new 2003 redefined 8-county area.)

Sources: U.S. Census Bureau; City of San Antonio, Department of Planning.

Area and Topography

The area of the City has increased through numerous annexations, and now contains approximately 521 square miles. The topography of San Antonio is generally hilly with heavy black to thin limestone soils. There are numerous streams fed with underground spring water. The average elevation is 788 feet above mean sea level.

Annexation

Through annexation, the City has grown from its original size of 36 square miles to its current area, encompassing 451 square miles (full purpose annexations only) or 521 square miles (both full purpose and limited purpose annexations), and having a fiscal year 2007 total market valuation of \$64.866 billion. The City expects to continue

to utilize the practice of annexation as a future growth and development management tool, as well as an opportunity to enhance the City's fiscal position. Planned annexations by the City are currently under consideration.

At its November 20, 2002 meeting, the City Council annexed, effective December 31, 2002, five areas for inclusion within the City for full purposes, adding 19 square miles of land to the City's total area. At that same meeting, the City Council also annexed, effective January 5, 2003 six areas for limited purposes. Effective August 1, 2004, City Council annexed an additional area for limited purposes south of the Medina River. In addition, effective June 20, 2005, City Council annexed the 4,345-acre Timberwood Park area for limited purposes. The areas annexed for limited purposes account for a total of 70 square miles of land within the City's corporate limits. Limited purpose annexation areas, although included in the total calculation of the City corporate limits, are excluded in the calculation of property values. (See "Limited Purpose Annexation" below).

Limited Purpose Annexation

The City annexed for limited purposes, effective January 5, 2003, six areas south of San Antonio. An additional area south of the Medina River was annexed August 1, 2004 and the Timberwood Park area, immediately east of Camp Bullis, was annexed effective June 20, 2005. Limited purpose annexation allows the City to extend regulatory authority for the limited purposes of applying its planning, zoning, health, and safety ordinances to specified areas. The City may not impose a property tax in such areas until the property is annexed for full purposes, which generally occurs within three years after limited purpose annexation.

As a requirement of Section 43.123, Texas Local Government Code, as amended, the City published a planning study and regulatory plan regarding the proposed limited purpose annexation areas. The planning study addresses projected levels of development in the next ten years with and without annexation of such areas, issues regarding (and the public benefits of) annexation, economic and environmental impact of annexation, and proposed zoning for the specified areas. The regulatory plan outlines development regulations and the respective dates of future, full purpose annexation.

Annexation Plan

In 1999, the Texas Legislature passed Chapter 1167, Acts of the 76th Legislature, Regular Session, 1999 (the "Annexation Act"), changing the manner in which Texas municipalities can annex land. Under the Annexation Act (such requirement now codified at Section 43.052, Texas Local Government Code), municipalities must prepare an annexation plan specifically identifying annexations that may occur beginning on the third anniversary of the date such plan was adopted.

The City Council, at its September 19, 2002 meeting, adopted a three-year annexation plan for the City. At its December 12, 2002 meeting, City Council amended the plan identifying 13 areas for full purpose annexation, as required by Section 43.052 of the Texas Local Government Code, two of these areas were annexed effective December 31, 2005, (along with two other voluntary annexations in December 2005) and two south side limited purpose annexation areas were annexed for full purposes on January 5, 2006. City Council approved an additional amendment to its annexation plan on July 22, 2004, to include the limited purpose annexation south of the Medina River, which is scheduled for full purpose annexation on July 31, 2007.

Form of Government and Administration

The City is a home rule municipality that operates pursuant to the Charter of the City of San Antonio City Charter (the "City Charter"), which was adopted on October 2, 1951 and became effective on January 1, 1952. The City Charter provides for a council-manager form of government. Pursuant to its provisions and subject only to the limitations imposed by the Texas Constitution and the City Charter, all powers of the City are vested in an elective Council (the "City Council") which enacts legislation, adopts budgets, and determines policies. The City Council is comprised of eleven (11) members, with ten (10) members elected from single-member districts, and the Mayor elected at-large. Each member of the City Council serves two (2) year terms, and each member is limited to a maximum of two (2) full terms. The office of the Mayor is considered a separate office. The terms of all members of the City Council currently sitting in office expire on May 31, 2007 or as soon thereafter as a successor is appointed and qualified.

The City Council also appoints a City Manager who executes the laws and administers the government of the City, and serves as the City's chief administrative officer. The City Manager serves at the pleasure of City Council.

City Charter

Since its adoption, the City Charter has been amended on five (5) separate occasions, November 1974, January 1977, May 1991, May 1997, and November 2001. Significant amendments to the City Charter include the amendment passed in May 1991, which limited the service by the Mayor and members of the City Council members to two full terms, each of which is two years in duration. Two (2) separate City Charter review committees sitting in the early and mid-1990's and charged with conducting a comprehensive review of the City Charter resulted in the passage of five propositions, each containing numerous amendments to the City Charter in May 1997. The most recent amendments to the City Charter occurred in 2001 and included, among others, provisions creating the position of an independent City Internal Auditor and granting the City Manager the power to appoint and remove the City Attorney upon the City Council's confirmation and advice, respectively.

Services

The full range of services the City provides to its constituents includes ongoing programs to provide health, welfare, art, cultural, and recreational services; maintenance and construction of streets, highways, drainage, and sanitation systems; public safety through police and fire protection; and urban redevelopment and housing. The City also considers the promotion of convention and tourism and participation in economic development programs high priorities. The funding sources from which these services are provided include ad valorem, sales, and hotel/motel tax receipts, federal and state grants, user fees, bond proceeds, tax increment financing, and other sources.

In addition to the above described general government services, the City provides services financed by user fees set at levels adequate to provide coverage for operating expenses and the payment of outstanding debt. These services include airport, parking, storm water, and environmental services.

Electric and gas services to the San Antonio area are provided by City Public Service ("CPS"), an electric and gas utility owned by the City that maintains and operates certain utilities infrastructure. This infrastructure includes a 19 generating unit electric system and the gas system that serves the San Antonio area. CPS operations and debt service requirements for capital improvements are paid from revenues received from charges to its customers. CPS is obligated to transfer a portion of its revenues to the City. CPS revenue transfers to the City for the City's fiscal year ending September 30, 2006 were \$246,084,171 (includes an additional transfer of \$8,438,363; Unaudited).

Water, wastewater, recycled water, steam, and chilled water services are provided by the San Antonio Water System ("SAWS"), another City-owned and operated utility. In addition to these services, SAWS contracted with the City to provide certain storm water services thereto and it manages and develops water resources in and around the San Antonio region. SAWS is in its 14th year as a separate, consolidated entity that addresses the City's water-related issues in a coordinated and unified manner. SAWS operations and debt service requirements for capital improvements are paid from revenues received from charges to its customers. SAWS is obligated to transfer a portion of its revenues to the City. SAWS revenue transfers to the City for the City's fiscal year ended September 30, 2006 were \$10,283,651 (Unaudited).

Economic Factors

The City supports a favorable business environment and economic diversification which is represented by various industries, including domestic and international trade, convention and tourism, medicine and health care, government employment, agribusiness, manufacturing, financial services, telecommunications, telemarketing, insurance, and oil and gas refining. Support for these economic activities is demonstrated by the City's commitment to its on-going infrastructure improvements and development and its dedicated work force. Total employment in the San Antonio MSA for February 2007 was 886,858, which is 15,164 or 1.74% more jobs than the February 2006 total of 871,694. Services, trade, and government represent the largest employment sectors in the San Antonio MSA. Finance (including insurance), healthcare and bioscience, tourism, and the military represent the largest industries in San Antonio.

Finance Industry

According to a study conducted by the Finance San Antonio Ad Hoc Committee, the finance industry is San Antonio's largest economic generator with an annual economic impact of \$20.5 billion in 2004. The industry employs 50,469 people to whom it pays an average wage of \$52,612, considerably higher than the average wage of \$33,911. Total wages paid in the industry amounted to \$2.66 billion in 2004. As a percent of total employment, the finance industry in San Antonio is the largest of any major metropolitan area in Texas. Compared to the growth in wages and employment in San Antonio overall, the finance industry experienced higher levels of average annual growth in these areas since 2001. Average annual growth in total wages paid by the finance industry for years 2001 through 2004 was 4.5%, compared to 4% for all industries. Average annual growth in employment in the finance industry over this same time period was 2.18%, compared to 0.36% for all other industries.

The largest sector in this industry is insurance. While this sector is led by USAA, San Antonio is home to several other insurance headquarters such as Argonaut Group, Catholic Life, GPM Life, as well as being the home to many regional operations centers for many health care insurers. Insurers with substantial regional operations centers in San Antonio include Caremark, United Health, and Pacificare.

The second largest sector in this industry is banking. Like insurance, San Antonio is also the home of many banking headquarters and regional operation centers such as Frost Bank, Broadway Bank, and USAA Bank. Companies with large regional operations centers in San Antonio include World Savings, Chase, and Citicorp. Each of these companies has experienced substantial growth since arriving in San Antonio, and they continue to grow today. In addition to this growth, Washington Mutual has just opened a regional operations center that will result in the creation of 2,000 to 5,000 jobs over the next several years.

Healthcare & Bioscience Industry

The healthcare and bioscience industry remains the largest industries in the San Antonio economy. The industry is diversified, with related industries such as research, pharmaceuticals, and manufacturing contributing approximately the same economic impact as health services. According to the *San Antonio's Healthcare and Bioscience Industry Economic Impact Study* commissioned by the Greater San Antonio Chamber of Commerce, the total economic impact from this industry sector totaled approximately \$13.7 billion in 2004. The industry provided more than 109,000 jobs, or approximately 14.6 percent of the City's total employment. The healthcare and bioscience industry's annual payroll in 2004 approached \$4.2 billion. The 2004 average annual wage of San Antonio workers was \$33,911, compared to \$38,531 for healthcare and bioscience employees. These 2004 economic impact figures represent growth of 4 percent over the previous year, or approximately \$800 thousand.

Health Care. The 900-acre South Texas Medical Center (the "Medical Center") has ten major hospitals and nearly 80 clinics, professional buildings, and health agencies with combined budgets of over \$2.5 billion as of January 2005. Approximately 26,757 Medical Center employees provided care for over 3.92 million outpatients and over 102,000 inpatients. Physical plant values, not adjusted for inflation, representing the original investments in physical facilities and equipment (less depreciation) represents approximately \$1.854 billion, which is a \$120 million increase in 2004 over the previous year. The Medical Center has about 300 acres of undeveloped land still available for expansion. Capital projects already in progress total \$65 million. Capital projects planned for the years 2006 through 2010 will add an additional estimated \$152 million to present physical plant and equipment values.

Central to the Medical Center is The University of Texas Health Science Center at San Antonio (the "UT Health Science Center") with its five professional schools awarding more than 50 degrees and certificates, including Doctor of Medicine, Doctor of Dental Surgery, and Doctor of Philosophy in nursing, allied sciences, and other fields. The UT Health Science Center oversees the new, federally-funded Regional Academic Health Center in the Rio Grande Valley with facilities in Harlingen, McAllen, Brownsville, and Edinburg. An extension campus is under construction in Laredo, Texas.

There are numerous other medical facilities outside the boundaries of the Medical Center, including 25 short-term general hospitals, two children's psychiatric hospitals, and two state hospitals. There are three Department of Defense hospitals, one of which is located in the Medical Center (as hereinafter described).

Military Health Care. San Antonio has three major military hospitals, each of which has positively impacted the City for decades. Brooke Army Medical Center ("BAMC") conducts treatment and research in a new, 1.5 million square foot facility at Fort Sam Houston United States Army Base, providing health care to nearly 600,000 military personnel and their families. BAMC is a level-one trauma center (the only one in the United States Army medical care system) and contains the world-renowned Institute of Surgical Research Burn Center. BAMC also conducts bone marrow transplants in addition to more than 600 ongoing research studies.

Wilford Hall Medical Center ("Wilford Hall") is the largest medical facility of the United States Air Force. In addition to providing health care to military personnel and their families, Wilford Hall is also a level-one trauma center (the only one in the United States Air Force medical care system) that handles emergency medical care for approximately one-fourth of the City's emergency patients. Wilford Hall provides medical education for the majority of its physician and dental specialists and other health professionals, conducts clinical investigations, and offers bone marrow and organ transplantation.

Audie L. Murphy Memorial Veterans Hospital, located in the Medical Center, is an acute care facility and supports a nursing home, the Spinal Cord Injury Center, an ambulatory care program, the Audie L. Murphy Research Services (which is dedicated to medical investigations), and the new Frank Tejeda Veterans Administration Outpatient Clinic (which serves veterans located throughout South Texas).

The two military medical care facilities and the Veterans Hospital partner in a variety of ways, including clinical research and the provision of medical care to military veterans. This partnership is unique and represents a valuable resource to San Antonio and the nation.

Biomedical Research and Development. Research and development are important areas that strengthen San Antonio's position as an innovator in the biomedical field, with total research economic impact exceeding \$1.005 billion annually.

The Texas Research Park (the "Park") is the site for the University of Texas Institute of Biotechnology/Department of Molecular Medicine, the Cancer Therapy and Research Center ("CTRC"), and CTRC's Research Center's Institute for Drug Development, The Southwest Oncology Group, and dozens of new biotechnology-related companies, whose work involves various stages of the very complicated drug development process. The Park has over \$100 million invested in its facilities and equipment and generates more than \$200 million in economic activity for the City each year. The Park is owned and operated by the Texas Research and Technology Foundation, whose mission includes building a world-class center for life-science research and medical education and promoting economic development through job creation.

The Southwest Foundation for Biomedical Research, which conducts fundamental and applied research in the medical sciences, is one of the largest independent, non-profit, biomedical research institutions in the United States, and is internationally renowned. The Southwest Foundation for Biomedical Research has a full time staff of 72 doctoral level employees, a technical staff of 115, and an administrative and supporting staff of 201 persons. Research departments include Departments of Genetics, Physiology and Medicine, Virology and Immunology, and Organic and Biological Chemistry. The Department of Laboratory Animal Medicine maintains the animal care facilities. The Foundation is also home to one of the few Biosafety Level 4 labs in the country, and its Genomics Computing is the world's largest computer cluster devoted to statistical genetic analysis.

The UT Health Science Center has been a major bioscience research engine since its inception, with strong research groups in cancer, cancer prevention, diabetes, drug development, geriatrics, growth factor and molecular genetics, heart disease, stroke prevention, and many other fields. One of its latest achievements is the establishment of the Children's Cancer Research Center, endowed with \$200 million from the State of Texas's tobacco settlement. The UT Health Science Center, along with the CTRC, forms the San Antonio Cancer Institute, a National Cancer Institute-designated Comprehensive Cancer Center.

UTSA houses the Cajal Neuroscience Research Center, which is funded by \$11 million in ongoing grants and is tasked with training students in research skills while they perform basic neuroscience research on subjects such as

aging and Alzheimer's disease. UTSA is also the recipient of more than \$35 million for its new School of Bioengineering.

A number of highly successful private corporations, such as Mission Pharmacal, DPT Laboratories, Ltd., and Genzyme Oncology, Inc., operate their own research and development groups and act as guideposts for numerous biotech startups, bringing new dollars into the area's economy. A notable example of the results of these firms' research and development is Genzyme Oncology, Inc., which has developed eight of the last eleven cancer drugs approved for general use by the Federal Drug Administration.

Hospitality Industry

The City's diversified economy includes a significant sector relating to the hospitality industry. A recent study by the Greater San Antonio Chamber of Commerce found that in 2004 the hospitality industry had an economic impact of nearly \$8.7 billion. The estimated annual payroll for the industry in 2004 was \$1.58 billion, and the industry employed over 94,000. The updated economic impact study is tentatively scheduled in 2008.

In 2006, the City's overall performance for hotel occupancy increased by 0.3%, revenue per available room ("RevPAR") increased by 9.7%, and total room nights sold in the destination increased by 2.2%.

Tourism. During 2004, San Antonio attracted over 21.3 million visitors with direct spending across all industries of \$4.3 billion and ranked tenth among U.S. destinations for overnight leisure travel, according to the National Performance Monitor survey conducted by D.K. Shifflet & Associates. This information is updated on a biennial basis with the next release scheduled for August 2007. The list of attractions in the San Antonio area includes, among many others, the Alamo, and other sites of historic significance, the River Walk, two major theme parks (SeaWorld of Texas and Six Flags Fiesta Texas), and the professional basketball team, the San Antonio Spurs.

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Conventions. San Antonio is one of the top convention cities in the country. The City is proactive in attracting convention business through its management practices and marketing efforts. The following table shows both overall city performance as well as convention activity booked by the San Antonio Convention & Visitors Bureau for the years indicated:

Fiscal Year Ended 9/30	Hotel Occupancy ¹	Revenue per Available Room (RevPAR) ¹	Room Nights Sold ¹	Convention Attendance ²	Convention Room Nights ²	Convention Delegate Expenditures (\$ Millions) ^{2,3}
1997	65.9%	\$48.06	6,123,089	417,492	670,039	\$341.9
1998	64.0%	\$51.11	6,525,601	445,151	724,882	\$401.0
1999	63.5%	\$51.17	6,691,994	406,539	678,014	\$366.2
2000	64.0%	\$53.57	7,033,908	389,448	696,215	\$350.8
2001	62.2%	\$52.58	6,982,313	419,970	712,189	\$378.3
2002	63.7%	\$53.76	7,237,045	483,452	693,921	\$435.5
2003	63.1%	\$51.82	7,408,223	429,539	613,747	\$387.0
2004	63.7%	\$53.43	7,540,685	491,287	621,640	\$510.5
2005	68.1%	\$60.35	8,126,397	503,601	699,932	\$523.3
2006	68.3%	\$66.23	8,303,038	468,636	717,097	\$487.0

¹ Data obtained from Smith Travel Research based on hotels in the San Antonio market report dated of March 21, 2007.

² Reflects only those conventions booked by the Convention and Visitors Bureau.

³ For the year 1997, the estimated dollar value is calculated in accordance with a 1993 Deloitte & Touche LLP study for the Destination Marketing Association International (DMAI), formerly the International Association of Convention and Visitor Bureaus ("IACVB"), which reflected the average expenditure of \$818.82 per convention and trade show delegate. Beginning in 1998, the estimated dollar value is calculated in accordance with the 1998 DMAI Foundation Convention Income Survey Report conducted by Deloitte & Touche LLP, which reflected the average expenditure of \$900.89 per convention and trade show delegate. Calendar years 2004 and 2005 are based on an average expenditure of \$1,039.20 per convention and trade show delegate, according to a Veris Consulting, LLC study for the DMAI.

Source: City of San Antonio, Convention and Visitors Bureau.

Military Industry

The military represents a principal component of the City's economy providing an annual economic impact for the City of over \$5 billion. Three major military installations are currently located in Bexar County, including Lackland Air Force Base ("Lackland AFB"), Fort Sam Houston Army Base ("Fort Sam"), and Randolph Air Force Base ("Randolph AFB"). In addition, the property of Brooks Air Force Base ("Brooks AFB"), a fourth major military installation, was transferred from the United States Air Force (the "Air Force") to the City-created Brooks Development Authority ("BDA") in 2002, as part of the Brooks City-Base Project ("Brooks City-Base"). Furthermore, the military is still leasing over two million square feet of space at KellyUSA, which is the former Kelly Air Force Base that was closed in 2001.

KellyUSA. On July 13, 2001, Kelly Air Force Base ("Kelly AFB") officially closed and the land and facilities were transferred to the Greater Kelly Development Authority ("GKDA"), a City Council-created organization responsible for overseeing the redevelopment of the base into a business and industrial park. The new business park, known as KellyUSA, is focused on becoming the Port of San Antonio by: (1) establishing international air cargo operations; (2) developing a rail port for direct international rail operations including inland port distribution with the Port of Corpus Christi; (3) expanding aviation maintenance, repair, and overhaul ("MRO") operations into a renowned international center of excellence for MRO.

As of December 2005, there were over 63 tenants employing over 12,469 people with an average salary of over \$38,000 and a total economic impact of \$2.76 billion per year. Major commercial employers at KellyUSA include Boeing, Lockheed Martin, General Electric, General Dynamics, Standard Aero, Pratt & Whitney, Chromalloy, Gore Design Completions, and EG&G.

With 95% of the marketable 8.2 million square feet leased, GKDA is now focused on development of new Class A facilities leveraging public and private investment to create more jobs for San Antonio. In 2005, a total of 514,400 square feet of new hangar, distribution, and flex/office facilities were constructed at KellyUSA. GKDA's development plan forecasts \$336 million of new construction for buildings and infrastructure over the next 5 years. KellyUSA's economic impact to San Antonio is projected to increase to over \$4.6 billion per year upon full build-out.

Brooks City-Base. Brooks City-Base continues to draw private business investment, however, the military missions will be relocated over the next three to five years as a result of the 2005 Base Realignment and Closure (see "BRAC" herein) recommendations. The City is several years ahead in redevelopment over the other military installations across the United States facing the same relocations and closures from the BRAC. Despite the BRAC decision, Brooks City-Base is continuing its goal of sustainability by creating a Tax Increment Reinvestment Zone that encompasses the area inside and outside the Brooks City-Base as another tool to assist in its development. As a timeline is determined for the departure of Air Force missions, the BDA will have a better idea how best to redevelop the approximately 2 million square feet of current total space including lab, office and light industrial space.

Currently, there are over \$170 million worth of projects planned for or which are already underway. Some of these project highlights include:

In 2005, the BDA and a local pharmaceutical company, Dermatological Products of Texas ("DPT") Laboratories, approved an eighteen-year build-to-suit lease agreement for a combination research and development warehouse and production facility of nearly 250,000 square feet at Brook-City Base. The project involves a capital investment of \$24 million and construction is underway on the two new major buildings located at Brooks City-Base.

Vanguard Health Systems, Inc. and its affiliate Baptist Health System ("BHS") announced in 2005 that BHS has signed a letter of intent to acquire land to relocate Southeast Baptist Hospital to Brooks City-Base and negotiations are ongoing. The new hospital will initially be sized for 175 beds, but ultimately, the hospital could grow to more than 400 beds. The new hospital will bring 700 to 800 jobs to the south side of San Antonio and represents a significant economic investment in the community. Ultimately, the hospital will be part of a medical campus with one medical office building being constructed concurrently with the hospital and six additional buildings constructed under a phased timeline.

A \$24.5 million Emergency Operations Center (the "EOC") is to be constructed at Brooks City-Base. The EOC, which will be financed through City and Bexar County proposed bond funds, will be the anchor of the planned Emergency Preparedness Institute, and will be a campus of City, County, Regional, State and Federal departments and/or personnel. The EOC is anticipated to be operational by December 2007.

The San Antonio Metropolitan Health District ("SAMHD") has completed renovation of a Brooks City-Base facility to establish a Biosafety Level 3 ("BSL3") Laboratory. SAMHD plans to institute additional public health capabilities at Brooks City-Base and is investigating plans to move the majority of its downtown resources to the BSL3 Laboratory at Brooks City-Base.

The Texas State Board of Education approved the charter school application filed by Somerset Academy in collaboration with the Brooks City-Base Foundation and the BDA, allowing for the development of a charter school at Brooks City-Base. Classes began August 14, 2006 and were moved to the newly constructed building at Brooks City-Base on March 26, 2007. The school's curriculum will focus on science and engineering, providing students with a unique opportunity to learn and participate in the cutting-edge Air Force programs found at Brooks City-Base and throughout San Antonio.

Fort Sam and Lackland AFB. Fort Sam is engaged in military-community partnership initiatives to help reduce infrastructure costs and pursue asset management opportunities using military facilities. In April 2000, the United States Army (the "Army") entered into a partnership with the private organization, Fort Sam Houston Redevelopment Partners, Ltd. ("FSHRP"), for the redevelopment of the former Brooke Army Medical Center and two other buildings at Fort Sam. These three buildings, totaling about 500,000 square feet in space and located in a

designated historic district, had been vacant for some time and were in a deteriorating condition. On June 21, 2001, FSHRP signed a 50-year lease with the Army to redevelop and lease these three properties to commercial tenants.

In September 2003, the Army relocated Army South Headquarters from Puerto Rico to Fort Sam, bringing approximately 500 new jobs to San Antonio with an annual economic impact of approximately \$200 million. The Army negotiated a lease with the FSHRP to locate United States Army South and the Southwest Region Installation Management Agency in the newly renovated historic facilities in the summer of 2004. The continued success of this unique public-private partnership at Fort Sam is critical to assisting the Army in reducing infrastructure support costs, preserving historical assets, promoting economic development opportunities, and generating net cash flow for both the Army and FSHRP.

This project supports the City's economic development strategy to promote development in targeted areas of the City, leverage military installation economic assets to create jobs, and assist our military installations in reducing base support operating costs. The Army intends to extend the public-private partnership initiative to include other properties at Fort Sam currently available for redevelopment.

Base Realignment and Closure ("BRAC"). On November 8, 2005, the recommendations of the BRAC Commission became law. As a result of BRAC, the San Antonio area will benefit from a net gain of about 3,600 jobs over the next three to five years. In addition, transformation is ongoing throughout the military services resulting in the reorganization of many military missions and units. For example, at Fort Sam, the Army transformation actions are expected to create an additional 4,000 jobs over the next few years in addition to the growth from BRAC discussed below. Furthermore, the Texas Cryptologic Center has announced an expansion of its activities in San Antonio and will be adding about 1,500 jobs over the next two years.

Key elements of BRAC include the creation of a the United States Department of Defense ("DoD") Regional Medical Center at the new BAMC and the establishment of Fort Sam Houston as the home for all DoD enlisted medical training. BAMC will be one of only two such DoD Regional Medical Centers in the country and will merge with the Wilford Hall at Lackland AFB. While the Wilford Hall facility at Lackland will close, the DoD intends to build a new 450,000 square foot medical care clinic at Lackland. In addition, a number of Army Agency Headquarters will also be relocating to Fort Sam from other bases around the country. As these changes occur over the next three to six years, Fort Sam Houston will grow by over 13,000 jobs to about 40,000. Based on the planned changes at Fort Sam and Lackland AFB, the community is also expecting to benefit from over \$2 billion in new construction and renovation of facilities at both bases. Finally, the recommended BRAC enhancements to military medical care training and capacity will also greatly strengthen and grow the currently existing partnerships between the military and community institutions. These will facilitate continued growth in the community's number one targeted industry of bioscience and healthcare.

Defense Transformation Institute ("DTI"). DTI is a non-profit entity established by the Texas Research and Technology Foundation in partnership with the City. DTI's mission is to leverage the assets at active duty military installations to create value for the military and the community. These military assets can include land, facilities, education, technology, research, and training. DTI is also prepared to act as the community's lead agency for partnering with the military to help plan, coordinate, implement, and accelerate the results of BRAC 2005 to the benefit of the military and the community. DTI is also partnering with the State to conduct workshops on how communities can effectively partner with their military counterparts to achieve mutual benefit.

Other Major Industries

Aerospace. The aerospace industry's annual economic impact to the City is about \$3.3 billion. This industry provides some 9,535 jobs, with employees earning total annual wages of over \$406 million. The aerospace industry continues to expand as the City leverages its key aerospace assets, which include San Antonio International Airport, Stinson Municipal Airport, KellyUSA, Randolph AFB and Lackland AFB, and training institutions. Many of the major aerospace industry participants have significant operations in San Antonio, such as Boeing, Lockheed Martin, General Electric, Pratt & Whitney, Raytheon, Cessna, San Antonio Aerospace – a division of Singapore Technologies, Southwest Airlines, American Airlines, Delta and Continental, FedEx, UPS, and others. The industry in San Antonio is much diversified with continued growth in air passenger service, air cargo, MRO, and general aviation.

Aerospace Research and Development. In May 2005, the National Sustainment Technology Center (NSTC) opened in San Antonio to research and develop solutions to address the challenges and requirements faced by the DoD in the maintenance of aging weapon systems. The NSTC falls under the Defense Sustainment Consortium ("DSC") which is a collaboration of DoD and industry stakeholders involved in the acquisition and support for DoD weapon systems. The NSTC will conduct funded pilot projects involving DSC members, academia, and government partners to produce innovative solutions for unique problems associated with aging weapon systems. The NSTC will also promote technology transfer from small business to DoD customers and defense contractors. By having the NSTC in San Antonio, local businesses, educational institutions, and other public/private entities can collaborate to compete for these research and development opportunities.

San Antonio Technology Accelerator Initiative. San Antonio Technology Accelerator Initiative ("SATAI") is a targeted economic development initiative focused on developing an advanced technology economy in the San Antonio region. SATAI's mission is to accelerate the regional technological economy through providing hands-on development of advanced technology start-up companies and assisting established companies in accessing technology-based solutions through Enterprise Services. SATAI recently became the home of the South Texas Regional Commercialization and Innovation Center ("STRCIC"). The STRCIC was established in response to the creation of the Emerging Technology Fund by the State of Texas. Its purpose is to review funding requests submitted by technology startup companies who are seeking funding from the Emerging Technology Fund.

In the 2005 legislative session, the State of Texas (the "State") created the \$200 million Emerging Technology Fund ("ETF"). The ETF is to be used to help foster the development of the technology industries in San Antonio by providing another source of financial capital to entrepreneurs, providing matching grants for research, and allocating funds to be used to acquire research superiority at colleges and universities throughout the state. In order to participate in the ETF, the Bexar County region is establishing a Regional Center of Innovation and Commercialization ("RCIC"), as required by law. The RCIC will review potential commercialization opportunities presented by local entrepreneurs and make recommendations for possible funding to the Texas Emerging Technology Committee. The State has recognized the SATAI to serve as the RCIC for the San Antonio region. In the first two rounds in which money was granted, three San Antonio companies received a total of \$2.8 million and UTSA received \$3.5 million to help attract world-class information security professors and researchers.

In May 2005, the community also formed the Defense Technology Cluster (the "Cluster") in partnership with the SATAI. The Cluster is a collaboration of local companies currently doing business with the Department of Defense and/or the Department of Homeland Security. Through this collaboration, the Cluster expects to attract more defense technology work to San Antonio, create an awareness of the technical capabilities of local firms, and promote the growth and expansion of defense technology companies in the community. The Cluster seeks to become the recognized source for information and resources on the talent and capabilities of firms in the San Antonio region available to support defense technology requirements.

Applied Research & Development. The Southwest Research Institute is one of the original and largest independent, nonprofit, applied engineering and physical sciences research and development organizations in the United States, serving industries and governments around the world in the engineering and physical sciences. Southwest Research Institute has contracts with the Federal Aviation Administration, General Electric, Pratt & Whitney, and other organizations to conduct research on many aspects of aviation, including testing synthetic jet fuel, developing software to assist with jet engine design, and testing turbine safety and materials stability. Southwest Research Institute occupies 1,200 acres and provides nearly two million square feet of laboratories, test facilities, workshops, and offices for more than 2,700 scientists, engineers, and support personnel.

Telecommunications Industry. San Antonio became the headquarters for AT&T, Inc. ("AT&T") after SBC Communications, Inc. ("SBC") acquired the New Jersey-based company for \$16 billion and took its name in 2005. The recently completed merger created one of the largest telecommunications and networking companies in the world and the largest national phone service provider. According to a published report, this will result in more than 100 AT&T employees relocating to San Antonio, including senior executives. The newly merged AT&T has approximately 189,950 employees worldwide as of December 2005.

Information Technology. The Information Technology ("IT") industry is one of the fastest growing sectors of the local economy. A study conducted in 2001, cites that the IT industry in San Antonio registered an overall economic impact of approximately \$3.4 billion which represents about seven percent of the San Antonio economy. The annual payroll among the IT industry's estimated 11,500 employees totals approximately \$500 million. The IT industry is particularly strong in the areas of information security and government contracting. The Center for Infrastructure Assurance and Security at the University of Texas at San Antonio is one of the leading research and education institutions in the area of information security in the country. In 2005, the United States National Security Agency (the "NSA") re-designated the University of Texas at San Antonio a National Center of Excellence in Information Assurance for three academic years. San Antonio is also home to the Air Intelligence Agency, which is the premier IT agency for the Air Force and the DoD. Adding to the growth of this industry, the Texas Cryptologic Center recently announced they are investing \$300 million in a new facility and adding at least 1,500 new jobs over the next few years in San Antonio.

Manufacturing Industry. The manufacturing industry of the City's economy has seen significant growth over the past two years, in large part due to the construction of the new Toyota Motor Manufacturing ("Toyota") facility and the development of the Toyota Supplier Park at its manufacturing site. Toyota will invest over \$850 million in this manufacturing facility, located on 2,000 acres in south San Antonio, and at full production, the facility will produce 200,000 full-size Tundra trucks. At full operations, the payroll for the 2,000 workers at the facility will total between \$90 and \$100 million. The Toyota Supplier Park has attracted 21 Tier-One supplier companies resulting in an additional capital investment of over \$300 million and 2,100 additional automotive manufacturing jobs.

In order to support the growth of the manufacturing sector, the Manufacturing Technology Academy was created in 2004. At this Academy, high school students learn many skills applicable to a variety of manufacturers, including manual and automated welding, machining, safety techniques, and total quality management.

Creative Industry. The creative industry in San Antonio registers a \$1.2 billion economic impact, employs 11,888 people, and pays annual wages of \$319 million. This industry consists of the following sectors, with economic impact in parentheses: performing arts (\$475.3 million), design, and advertising (\$401.1 million), museums and collections (\$233.7 million), visual arts and photography (\$84.0 million), and fine arts schools (\$22.1 million). If the printing, publishing, and broadcasting sectors were included, the economic impact would be \$3.5 billion. Recognizing the overall impact of this industry, *The Cultural Collaborative: A Plan for San Antonio's Creative Economy*, was created and a strategic plan was developed to provide focus and initiative for the future of this industry.

Sources: The Greater San Antonio Chamber of Commerce; San Antonio Medical Foundation; City of San Antonio, Department of Economic Development and Convention and Visitors Bureau.

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Growth Indices

San Antonio Electric and Gas Customers

For the Month of December	Electric Customers	Gas Customers
1997	538,729	301,044
1998	548,468	301,842
1999	560,628	302,991
2000	575,461	305,181
2001	589,426	305,702
2002	594,945	306,503
2003	602,185	306,591
2004	617,261	308,681
2005	638,344	310,699
2006	662,029	314,409

Source: CPS.

San Antonio Water System Average Customers per Fiscal Year

Fiscal Year Ended May 31 ^{1,2}	Water Customers ³
1997	273,276
1998	270,897
1999	279,210
2000	285,887
2001	292,136
2002	298,215
2003	303,917
2004	311,554
2005	323,149
2006	331,476

¹ On April 3, 2001, the SAWS Board of Trustees approved the changing of SAWS' fiscal year from a year-end of May 31 to December 31.

² Beginning in year 2001, for the 12 months ending December 31.

³ Excluding SAWS irrigation customers.

Source: SAWS.

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Construction Activity

Set forth below is a table showing building permits issued for construction within the City at December 31 for the years indicated:

Calendar Year	Residential Single Family		Residential Multi-Family ¹		Other ²	
	Permits	Valuation	Permits	Valuation	Permits	Valuation
1997	4,240	\$ 257,052,585	155	\$ 42,859,473	8,170	\$ 717,988,779
1998	5,630	363,747,169	85	23,194,475	8,193	892,766,648
1999	5,771	398,432,375	404	157,702,704	9,870	911,543,958
2000	5,494	383,084,509	201	81,682,787	10,781	957,808,435
2001	6,132	426,766,091	449	142,506,920	12,732	1,217,217,803
2002	6,347	435,090,131	246	101,680,895	14,326	833,144,271
2003	6,771	521,090,684	141	2,738,551	13,813	1,041,363,980
2004	7,434	825,787,434	206	7,044,283	14,695	1,389,950,935
2005	8,207	943,804,795	347	5,221,672	20,126	1,772,959,286
2006	7,301	890,864,655	560	13,028,440	19,447	1,985,686,296

¹ Includes two-family duplex projects.

² Includes commercial building permits, commercial additions, improvements, extensions, and certain residential improvements.

Source: City of San Antonio, Department of Development Services.

Total Municipal Sales Tax Collections – Ten Largest Texas Cities

	Calendar Year				
	2006	2005	2004	2003	2002
Amarillo	\$ 53,770,280	\$ 50,524,792	\$ 48,155,445	\$ 44,581,868	\$ 44,201,183
Arlington	77,179,657	61,983,154	49,344,558	46,483,314	42,493,256
Austin	133,503,393	118,853,520	112,515,478	105,044,871	110,208,923
Corpus Christi	55,663,395	51,046,479	47,647,095	43,498,880	41,237,025
Dallas	217,223,165	199,585,955	192,972,586	184,263,151	192,542,321
El Paso	60,737,389	54,217,823	51,461,838	48,949,656	47,465,776
Fort Worth	92,739,620	83,754,760	76,202,528	72,772,964	72,632,487
Houston	440,687,609	380,871,932	355,616,488	325,284,967	334,122,179
Plano	62,015,005	53,036,662	49,453,998	46,876,867	45,309,249
SAN ANTONIO	195,966,662	161,951,337	157,284,972	152,360,840	153,207,656

Source: State of Texas, Comptroller's Office.

Education

There are 15 independent school districts within Bexar County with a combined enrollment of 281,371 encompassing in the aggregate 41 high schools, 70 middle/junior high schools, and 247 elementary schools as of October 2005. There are an additional 25 charter school districts with 53 open enrollment charter schools at all grade levels. In addition, Bexar County has 94 accredited private and parochial schools at all education levels. Generally, students attend school in the districts in which they reside. There is currently no busing between school districts in effect.

The six largest accredited and degree-granting universities, which include a medical school, a dental school, and a law school, and four public community colleges, had combined enrollments of 96,943 for fall 2005.

Source: Texas Education Agency.

Employment Statistics

The following table shows current nonagricultural employment estimates by industry in the San Antonio MSA for the period of February 2007, as compared to the prior periods of January 2007 and February 2006.

Employment by Industry

San Antonio MSA ¹	February 2007	January 2007	February 2006
Mining	3,300	3,300	3,000
Construction	48,100	48,400	46,700
Manufacturing	49,200	49,200	47,700
Trade, Transportation, and Utilities	141,800	142,600	140,400
Information	20,200	20,300	20,500
Financial Activities	64,800	64,600	63,100
Professional and Business Services	106,400	105,300	100,300
Educational and Health Services	113,800	112,700	109,600
Leisure and Hospitality	91,600	89,500	88,900
Other Services	28,700	28,500	27,000
Government	149,600	147,600	147,800
Total Nonagricultural	817,500	812,000	795,000

The following table shows civilian labor force estimates, the number of persons employed, the number of persons unemployed, and the unemployment rate in the San Antonio MSA, Texas, and the United States for the period of February 2007, as compared to the prior periods of January 2007 and February 2006.

Unemployment Information (all estimates are in thousands)

San Antonio MSA ¹	February 2007	January 2007	February 2006
Civilian Labor Force	927.9	927.0	916.3
Number of Employed	886.9	886.1	871.7
Number of Unemployed	41.0	40.9	44.6
Unemployment Rate %	4.4	4.4	4.9
Texas (Actual) ¹	February 2007	January 2007	February 2006
Civilian Labor Force	11,520.3	11,526.6	11,355.4
Number of Employed	10,977.1	10,980.1	10,748.2
Number of Unemployed	543.2	546.5	607.2
Unemployment Rate %	4.7	4.7	5.3
United States (Actual) ²	February 2007	January 2007	February 2006
Civilian Labor Force	151,879.0	151,924.0	149,686.0
Number of Employed	144,479.0	144,275.0	141,994.0
Number of Unemployed	7,400.0	7,649.0	7,692.0
Unemployment Rate %	4.9	5.0	5.1

¹ Based on Labor Market Information Department, Texas Workforce Commission (model-based methodology).

² Based on Bureau of Labor Statistics, U.S. Department of Labor (Current Population Survey).

**Employers with 500 or More Employees in the San Antonio Metropolitan Area
(Includes Bexar, Comal, Guadalupe, and Wilson Counties)¹**

Firm	Product/Service	Firm	Product/Service
Construction:			
CCC Group, Inc.	Industrial Contractor	Urban Concrete Contractors, Ltd.	Exterior Concrete Contractor
Design Electric	Electrical Contractor	Zachry Group	Industrial General Contracting
Finance, Insurance, & Real Estate:			
American Funds	Mutual Funds & Investments	San Antonio Federal Credit Union	Credit Union/Financial Services
Argonaut Group	Insurance	Security Service Federal Credit Union	Credit Union/Financial Services
Bank of America - San Antonio	Commercial & Individual Banking	The Hartford	Personal Insurance
Frost National Bank	Financial Services & Insurance	The Lynd Company	Real Estate Brokerage
Humana	Medical Insurance Plans	USAA	Insurance/Financial Services
JP Morgan Chase Bank	Commercial & Individual Banking	Washington Mutual Bank	Banking, Financial Services
Pacificare	Medical Insurance Plans	Wells Fargo Bank	Banking, Financial Services
Randolph-Brooks FCU	Credit Union/ Financial Services	World Savings	Banking, Financial Services
SWBC	Insurance, Residential Mortgages		
Government:			
Bexar County	County Government	Randolph Air Force Base	Military Installation
Brooks City-Base	Military Installation	San Antonio Housing Authority	Public Housing Assistance
City of San Antonio	Municipal Government	Texas Department of Transportation	Highway Construction/Maint.
Education Service Center Region 20	State Education Service Agency	Texas Dept. of Family & Child Protective Services	State Social Services
Fort Sam Houston-US Army Base	Military Installation	Texas Dept. of Health & Human Services	State Social Services
Guadalupe County	County Government	VIA Metropolitan Transit	Urban Public Transportation
Lackland Air Force Base	Military Installation		
Manufacturing:			
Alamo Concrete Products	Concrete Products	Miller Curtain Company	Curtains, Draperies, & Bedspreads
Cardell Cabinetry	Cabinetry	Motorola	Electronics
Clarke American	Check Printing	SAS Shoemakers	Shoes
Coca-Cola Bottling Co. of the SW	Soft Drinks, Beverages	SMI-Texas	Steel
DPT Laboratories, Ltd.	Pharmaceuticals	San Antonio Aerospace	Aircraft Modification/Maint.
Friedrich Air Conditioning Co.	HVAC Systems	San Antonio Express-News	Daily Newspaper
Frito-Lay, Inc.	Snack Foods	Sino-Swearingen Aircraft Co.	Aircraft Design, Marketing/Sales
Kinetic Concepts, Inc.	Specialty Medical Products	Tesoro Corporation	Refining/Sales of Petroleum Prod.
L & H Packing Company	Meat Packing	The Scooter Store, Inc.	Medical & Dental Equipment
Lancer Corporation	Beverage Dispensing Equipment	Valero Energy Corporation	Refining/Sales of Petroleum Prod.
Martin Marietta Materials SW, Inc.	Concrete, Limestone, & Asphalt	Vulcan Materials	Materials, Cement, & Concrete
Medical:			
Advanced Living Technologies	Skilled Nursing Care Facilities	Methodist Healthcare System	General Acute Care Hospitals
Allied Primary Home Care Svcs.	Home Health Care Services	Methodist Specialty & Transplant Hosp.	Specialty Care Hospital
Baptist Health System	General Acute Care Hospitals	Metropolitan Methodist Hospital	General Acute Care Hospital
Brooke Army Medical Center	Military Hospital	Nix Health Care System	Hospital/Health Care Services
Caremark Prescription Service	Mail Order Pharmacy	Outreach Health Services	Home Health Care
Center for Health Care Services	Mental Health/Mental Retardation	San Antonio State Hospital	Mental Health/Mental Retardation
Christus Santa Rosa Health Care	General Acute Care Hospitals	San Antonio State School	Residential Care Facility
Girling Health Care, Inc.	Home Health Care Services	South Texas Blood & Tissue Center	Collect/Distribute Blood & Tissue
Guadalupe Valley Hospital	Hospital/Health Care Services	South Texas Veterans Health Care Sys.	Hospital/Health Care Services
Home Nursing & Therapy Svcs.	Home Health Care	Southwest General Hospital	Hospital/Health Care Services
Interim Healthcare San Antonio	Nurses' Registry	University of Texas Health Science	Medical School
McKenna Memorial Hospital	Hospital/Health Care Services	Center at San Antonio	Public Hospital/Clinics
Medical Team, Inc.	Home Health Care	University Health System	
Methodist Children's Hospital	Children's Hospital		
Retail:			
Aaron Rents and Sells Furniture	Office & Residential Furniture	H-E-B Grocery Company	Groceries & Distribution
Ancira Enterprises	Automotive Sales & Service	HOLT CAT	Caterpillar Heavy Equipment
Brylane	Mail Order & Catalog Shopping	QVC San Antonio Inc.	Electronic Retail Sales
CVS/Pharmacy	Pharmacy Stores	R & L Foods, Inc.	Fast Foods
Dillard's Department Stores	Department Stores	Sun Harvest Farms, Inc.	Natural Food Grocery Stores
Eye Care Centers of America, Inc.	Eyewear	Target Stores	Discount Retail Stores
Foley's Department Stores	Department Stores	Twigland Fashions Ltd.	Women's Apparel
Gunn Automotive Group	Auto Dealerships		

¹ January 2006, The Greater San Antonio Chamber of Commerce Largest Employer's Directory.

(Table continues on next page.)

**Employers with 500 or More Employees in the San Antonio Metropolitan Area
(Includes Bexar, Comal, Guadalupe, and Wilson Counties)¹**

Firm	Product/Service	Firm	Product/Service
Services:			
AT & T Center	Sports/Events Arena	New Braunfels I.S.D.	Public School District
Able Body Labor	Temporary Staffing	Northside I.S.D.	Public School District
Administaff, Inc.	Professional Staffing	Our Lady of The Lake University	Higher Education, Private
Advanced Temporaries, Inc.	Temporary Staffing	Palo Alto College	Junior/Community College
Advantage Rent-A-Car	Vehicle Rental	Parent/Child Inc.	Early Childhood Development
Air Force Village Foundation	Military Retirement Communities	Pioneer Drilling Company	Oil & Gas Drilling
Alamo Community College District	Public College District	RK Group	Catering
Alamo Heights I.S.D.	Public School District	Regal Cinemas	Movie Theaters
Alamodome	Domed Stadium	San Antonio College	Junior/Community College
Allen Tharp & Associates	Catering	San Antonio I.S.D.	Public School District
American Building Maintenance	Janitorial Contractor	Saniters, Inc.	Commercial Janitorial
Archdiocese of San Antonio	Catholic Archdiocese	Schertz-Cibolo-Universal City I.S.D.	Public School District
Avance Inc.	Family Support & Education	Schlitterbahn Waterpark & Resort	Resort & Waterpark
Bill Miller Bar-B-Q Ent., Ltd	Restaurants & Catering	SeaWorld San Antonio	Entertainment/Amusement Park
Boeing Aerospace Support Center	Aerospace Support Center	Sears Customer Service Center	Customer Service Center
Cadbeck Staffing	Temporary Staffing	Securitas Security Services USA	Guard/Security Service
Calling Solutions, Inc.	Telemarketing	Seguin I.S.D.	Public School District
Citicorp - U.S. Service Center	Service Center	Six Flags Fiesta Texas	Entertainment/Amusement Park
Comal I.S.D.	Public School District	Somerset I.S.D.	Public School District
East Central I.S.D.	Public School District	South San Antonio I.S.D.	Public School District
Edgewood I.S.D.	Public School District	Southside I.S.D.	Public School District
Employers Resource Management	Temporary Staffing	Southwest I.S.D.	Public School District
Enterprise/Rent-A-Car Company	Vehicle Rental	Southwest Research Institute	Research & Development
Floresville I.S.D.	Public School District	Spectrum Health Club	Health Clubs
Frontier Enterprises	Restaurant Headquarters	St. Mary's University	Higher Education, Private
Goodwill Industries of S.A.	Vocational Training	St. Philip's College	Junior/Community College
Harcourt Assessment, Inc.	Test Publishers	Standard Aero, Inc.	Repair Aircraft Engines
Harlandale I.S.D.	Public School District	Taco Cabana, Inc.	Fast Food Restaurants
Hospital Klean of Texas, Inc.	Hospital Housekeeping	Talent Tree, Inc.	Temporary Staffing
Hyatt Hill Country Resort and Spa	Hotel Resort & Spa	Tansec Inc./Div. of Radio Shack	Alarms & Monitoring
Infonxx	Information Retrieval Services	Treco Services, Inc.	Janitorial, Window Cleaning
Judson I.S.D.	Public Education	Trinity University	Higher Education, Private
Little Caesar's of San Antonio, Inc.	Pizza Take Out Stores	University of Texas at San Antonio	Higher Education, Public
Lockheed Martin Kelly Aviation	Aviation Consultants	University of The Incarnate Word	Higher Education, Private
Luby's Cafeterias, Inc.	Cafeterias	VIP Temporaries	Temporary Staffing
MTC, Inc.	Full Service Restaurants	Waste Management Inc.	Refuse Systems
Marriott Rivercenter/Riverwalk Hotels	Hotels	Wendy's of San Antonio Inc.	Fast Food Restaurants
McDonald's-Haljohn, Inc.	Fast Food Restaurants	Westaff	Temporary Staffing
Mi Tierra Cafe & Bakery, Inc.	Restaurant & Bakery	Whataburger	Fast Food Restaurants
Morningside Ministries	Retirement & Nursing Homes	YMCA of Greater of San Antonio	Health & Wellness
Transportation, Communications, & Utilities:			
AT&T, Inc.	Voice, Data, Telecommunications	Time Warner	Voice, Data, Telecommunications
CPS Energy	Natural Gas & Electric Service	U.S. Postal Service	Postal Delivery
San Antonio Water System	Water Services	United Parcel Service	Parcel Delivery
Southwest Airlines	Air Transportation		
Wholesale:			
Advantage Sales & Marketing	Sales & Marketing	SYGMA Network, Inc.	Distributor - Groceries
CARQUEST Auto Parts	Automotive Replacement Parts	San Antonio Auto Auction	Auto Auction
Color Spot Nurseries/SW Division	Plant Nurseries	Tyson Foods, Inc.	Poultry Slaughtering & Packing

¹ January 2006, The Greater San Antonio Chamber of Commerce Largest Employer's Directory.

San Antonio Electric and Gas Systems

The San Antonio Electric and Gas Systems are contained in the body of this Official Statement.

San Antonio Water System

History and Management

In 1992, the City Council consolidated all of the City's water related functions, agencies, and activities into one agency. This action was taken due to the myriad of issues confronting the City related to the development and protection of its water resources. The consolidation provided the City with a singular, unified voice of representation when promoting or defending the City's goals and objectives for water resource protection, planning, and development with local, regional, state, and federal water authorities and officials.

Final City Council approval for the consolidation was given on April 30, 1992 with the approval of Ordinance No. 75686 (the "System Ordinance"), which created the City's water system ("SAWS"), a single, unified system consisting of the former City departments comprising the waterworks, wastewater, and water reuse systems, together with all future improvements and additions thereto, and all replacements thereof. In addition, the System Ordinance authorizes the City to incorporate into SAWS a stormwater system and any other water related system to the extent permitted by law.

The City believes that establishing SAWS has helped to reduce the costs of operating, maintaining, and expanding the water systems and has allowed the City greater flexibility in meeting future financing requirements. More importantly, it has allowed the City to develop, implement, and plan for its water needs through one agency.

The complete management and control of SAWS is vested in a board of trustees (the "SAWS Board") currently consisting of seven members, including the City's Mayor and six persons who are residents of the City or reside within the SAWS service area. With the exception of the Mayor, all SAWS Board members are appointed by the City Council for four-year staggered terms and are eligible for reappointment for one additional four-year term. Four SAWS Board members must be appointed from four different quadrants in the City, and two SAWS Board members are appointed from the City's north and south sides, respectively. SAWS Board membership specifications are subject to future change by City Council.

With the exception of fixing rates and charges for services rendered by SAWS, condemnation proceedings, and the issuance of debt, the SAWS Board has absolute and complete authority to control, manage, and operate SAWS, including the expenditure and application of gross revenues, the authority to make rules and regulations governing furnishing to customers, and their subsequent payment for, SAWS' services, along with the discontinuance of such services upon the customer's failure to pay for the same. The SAWS Board, to the extent authorized by law and subject to certain various exceptions, also has authority to make extensions, improvements, and additions to SAWS and to acquire by purchase or otherwise properties of every kind in connection therewith.

Service Area

SAWS provides water and wastewater service to the majority of the population within the corporate limits of the City and Bexar County, which totals approximately 1.6 million residents. SAWS employs approximately 1,600 personnel and maintains over 9,100 miles of water and sewer mains.

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Historical Water Consumption (Million Gallons) ¹

<u>Fiscal Year Ended</u>	<u>Daily Average</u>	<u>Peak Day</u>	<u>Peak Month</u>	<u>Metered Usage</u>	<u>Metered Water Revenue</u>
05/31/2001	155	267	July	53,047	73,166,293
12/31/2001 ²	159	274	July	53,077	74,541,211
12/31/2002	143	222	August	51,850	77,801,600
12/31/2003	150	303	August	50,576	76,913,150
12/31/2004	144	295	August	49,366	77,113,717
12/31/2005	172	278	July	55,005	98,869,037

¹ Unaudited.

² On April 3, 2001, the SAWS Board approved the changing of the fiscal year from a year-end of May 31 to December 31. Report is for the twelve (12) months ending December 31, 2001.

Source: SAWS.

Water Consumption by Customer Class (Million Gallons) ¹

	<u>December 31, 2005</u>	<u>December 31, 2004</u>	<u>December 31, 2003</u>	<u>December 31, 2002</u>	<u>December 31, 2001 ²</u>	<u>May 31, 2001</u>
Residential	31,114	27,173	27,760	28,372	29,003	28,694
Commercial	12,991	11,746	11,730	11,942	12,371	12,384
Apartment	8,004	7,663	7,794	7,791	7,718	7,783
Industrial	2,122	2,089	2,473	2,696	2,670	2,737
Wholesale	121	99	136	173	531	535
Municipal	652	596	683	876	784	914
	<u>55,005</u>	<u>49,366</u>	<u>50,576</u>	<u>51,850</u>	<u>53,077</u>	<u>53,047</u>

¹ Unaudited.

² On April 3, 2001, the SAWS Board approved the changing of the fiscal year from a year-end of May 31 to December 31. Report is for the twelve (12) months ending December 31, 2001.

Source: SAWS.

SAWS System

SAWS includes all water resources, properties, facilities, and plants owned, operated, and maintained by the City relating to supply, storage, treatment, transmission, and distribution of treated potable water, chilled water, and steam (collectively, the "waterworks system"), collection and treatment of wastewater (the "wastewater system"), and treatment and recycle of wastewater (the "recycle water system") (the waterworks system, the wastewater system, and the recycle water system, collectively, the "system"). The system does not include any "Special Projects," which are declared by the City, upon the recommendation of the SAWS Board, not to be part of the system and are financed with obligations payable from sources other than ad valorem taxes, certain specified revenues, or any water or water-related properties and facilities owned by the City as part of its electric and gas system.

In addition to the water related utilities that the SAWS Board has under its control, on May 13, 1993, the City Council approved an ordinance establishing initial responsibilities over the stormwater quality program with the SAWS Board and adopted a schedule of rates to be charged for stormwater drainage services and programs. As of the date hereof, the stormwater program is not deemed to be a part of the system.

Waterworks System. The City originally acquired its waterworks system in 1925 through the acquisition of the San Antonio Water Supply Company, a privately owned company. Since such time and until the creation of SAWS in 1992, management and operation of the waterworks system was under the control of the City Water Board. The SAWS' service area currently extends over approximately 561 square miles, making it the largest water purveyor in Bexar County. SAWS serves more than 80% of the water utility customers in Bexar County and provides potable water service to approximately 326,000 customers, which includes residential, commercial, multifamily, industrial, and wholesale accounts. To service its customers, the waterworks system utilizes 24 elevated storage tanks and 35 ground storage reservoirs, of which 9 act as both, with combined storage capacities of 164.28 million gallons. As of 2005, the waterworks system had in place 4,404 miles of distribution mains, ranging in size from 6 to 61 inches in diameter (the majority being between six and 12 inches), and 23,212 fire hydrants distributed evenly throughout the SAWS service area.

Wastewater System. The San Antonio City Council created the City Wastewater System in 1894. A major sewer system expansion program began in 1960 with bond proceeds that provided for new treatment facilities and an enlargement of the wastewater system. In 1970, the City became the Regional Agent of the Texas Commission on Environmental Quality ("TCEQ") (formerly known as the Texas Water Commission and the Texas Water Quality Board). The Regional Agent Boundary encompasses approximately 360 square miles within Bexar County. In 1992, the wastewater system was consolidated with the City's waterworks and recycle water system to form the System.

SAWS serves the residents of the City, 18 governmental entities, and other customers outside the corporate limits of the City. As Regional Agent, SAWS has certain prescribed boundaries that currently cover an area of approximately 403 square miles. SAWS also coordinates with the City for wastewater planning for the City's total planning area, extra-territorial jurisdiction ("ETJ"), of approximately 956 square miles. The population for this planning area is approximately 1.2 million people. SAWS currently provides wastewater services to approximately 354,900 customers.

In addition to the treatment facilities owned by SAWS, there are six privately owned and operated sewage and treatment plants within the San Antonio ETJ.

The wastewater system is composed of approximately 4,607 miles of mains; three major treatment plants (Dos Rios, Leon Creek and Salado Creek); and a smaller treatment plant (Medio Creek). The three major plants are activated sludge facilities and the small plant is an extended aeration plant. SAWS holds Texas Pollutant Discharge Elimination System wastewater discharge permits, issued by the TCEQ for each of these four plants which have a combined treatment capacity of 225.7 million gallons per day. In addition, SAWS operates and maintains several small satellite facilities that vary in number and are temporary, pending completion of interceptor sewers that will connect the flow treated at such facilities to the wastewater system. The permitted flows from the wastewater system's four regional treatment plants represent approximately 98% of the municipal discharges within the ETJ.

Recycling Water System. SAWS is permitted to sell Type I (higher quality) recycled water from its wastewater treatment plants, and has been doing so since 2000. The recycle system is comprised of two north/south transmission lines and an interconnecting line that will be operational in the spring of 2006. Current capacity is 35,000 acre-feet.

Chilled Water and Steam System. SAWS owns and operates eight thermal energy facilities providing chilled water and steam services to governmental and private entities. Two of the facilities, located in the City's downtown area, provide chilled water and/or steam service to 23 customers. Numerous City facilities that include the Convention Center and Alamodome constitute approximately 75% of the downtown system's chilled water and steam annual production requirements. The remaining six thermal energy facilities, owned and operated by SAWS, provide chilled water and steam services to large industrial customers located in the KellyUSA industrial area on the City's west side. Additionally, under a Memorandum of Agreement with the Brooks Development Authority, SAWS provides operational and maintenance services for the Brooks City-Base central thermal energy facility and two small satellite sites. Together, chilled water and steam services produced \$13,370,759 in revenues in fiscal year 2005.

Stormwater System. In September 1997, the City created its Municipal Drainage Utility and established its Municipal Drainage Utility Fund to capture revenues and expenditures for services related to the management of the municipal drainage activity in response to EPA-mandated stormwater runoff and treatment requirements. The City, along with SAWS, has the responsibility, pursuant to the "Authorization to Discharge under the National Pollutant Discharge Elimination System" (the "Permit"), for water quality monitoring and maintenance. The City and SAWS have entered into an interlocal agreement to set forth the specific responsibilities of each regarding the implementation of the requirements under the Permit. The approved annual budget for the SAWS share of program responsibilities for fiscal year 2006 is \$3,447,599, for which SAWS is reimbursed \$3,056,345 from the stormwater utility fee imposed by the City.

Water Supply

Until recently, the City obtained nearly all of its water from the Edwards Aquifer. The Edwards Aquifer lies beneath an area approximately 3,600 square miles in size. Including its recharge zone, it underlies all or part of 13 counties, varying from five to 30 miles in width, and stretching over 175 miles in length, beginning in Bracketville, Kinney County, Texas, in the west and stretching to Kyle, Hays County, Texas, in the east. The Edwards Aquifer receives most of its water from rainfall runoff, rivers, and streams flowing across the 4,400 square miles of drainage basins located above it.

Much of the Edwards Aquifer region consists of agricultural land, but it also includes areas of population ranging from communities with only a few hundred residents to the City, which serves as a home for well over one million residents. The Edwards Aquifer supplies nearly all the water for the municipal, domestic, industrial, commercial, and agricultural needs in this region. Naturally occurring artesian springs, such as the Comal Springs and the San Marcos Springs, are fed by Edwards Aquifer water and are utilized for commercial, municipal, agricultural, and recreational purposes, while at the same time supporting ecological systems containing rare and unique aquatic life.

The Edwards Aquifer is recharged by seepage from streams and by precipitation infiltrating directly into the cavernous, honeycombed, limestone outcroppings in its north and northwestern area. Practically continuous recharge is furnished by spring-fed streams, with stormwater runoff adding additional recharge, as well. The historical annual recharge to the reservoir is approximately 684,700 acre-feet. The average annual recharge over the last four decades is approximately 797,900 acre-feet. The lowest recorded recharge was 43,000 acre-feet in 1956, while the highest was 2,485,000 acre-feet in 1992. Recharge has been increased by the construction of recharge dams over an area of the Edwards Aquifer exposed to the surface known as the recharge zone. The recharge dams, or flood-retarding structures, slows floodwaters and allows much of the water that would have otherwise bypassed the recharge zone to infiltrate the Edwards Aquifer.

Enhancing the City's Water Supply

The City has relied on the Edwards Aquifer as its sole source of water since the 1800s. Beginning in the 1980s and continuing today, however, the management of the water in the Edwards Aquifer has been the subject of intense scrutiny that has led to both extensive litigation and federal and state agency initiation of regulatory action. In 1993, the Texas Legislature adopted the Edwards Aquifer Authority Act, which created a new regulatory agency to manage withdrawals from the Edwards Aquifer and to protect springflows. This agency, known as the Edwards Aquifer Authority ("EAA"), is charged with preserving and protecting the Edwards Aquifer in an eight-county region including all of Uvalde, Medina, and Bexar counties, plus portions of Atascosa, Caldwell, Guadalupe, Comal, and Hays counties.

Based upon population and water demand projections, along with various regulatory and environmental issues, the City recognizes that additional water sources will be required to supplement withdrawals from the Edwards Aquifer to enable the City to meet its long-term water needs.

SAWS is charged with the responsibility of identifying additional water resources for the City and its surrounding areas. New water resource projects range from optimizing the City's current source through conservation measures, to identification and procurement of completely new and independent water sources. These efforts are guided by SAWS long-term water resource planning process, which commenced in 1998 with the adoption of a 50-year water resource plan. The 1998 plan established mechanisms for formulating and implementing programs to enhance the

City's water supply. In October 2000, the City Council created a permanent funding mechanism (the "Water Supply Fee") to be used for water supply development and water quality protection.

The Water Supply Fee is based upon a uniform rate per 100 gallons of water used and is applied to all SAWS customers.

A listing of scheduled water supply fees for years 2001 through 2005 is provided in the following table:

Year	Approved Incremental Charge Per 100 Gallons	Total Approved Charge Per 100 Gallons	Actual Assessment
2001	\$ 0.0358	\$ 0.0358	\$ 0.0358
2002	0.0350	0.0708	0.0708
2003	0.0230	0.0938	0.0844
2004	0.0190	0.1128	0.1100
2005	0.0250	0.1378	0.1378

Source: SAWS, approved by City Council.

On November 17, 2005, the City Council approved the following Water Supply Fee effective January 1, 2006.

Year	Fee Assessed Per 100 Gallons
2006	\$ 0.1487

In August 2005, the 1998 plan was updated to incorporate changes in population forecasts, to reflect the achievements gained through SAWS conservation program, and to identify the best portfolio of water supply projects for meeting San Antonio's future needs. Through this process, SAWS determined that the City's water needs can be met through an array of programs, including a critical period management plan, conservation, reuse, non-Edwards Aquifer groundwater, enhanced recharge capabilities, and aquifer storage and recovery among others. Based on the results of this analysis, the SAWS Board of Trustees approved the 2005 update on August 16, 2005 and directed the SAWS staff to:

- a. Planning Scenario 2: Service as the regional water provided and contact every independent water retailer in Bexar County to see how SAWS can work with them on their long-term water supply needs.
- b. Edwards Supply: Solidify the Edwards Aquifer inventory by converting the approximately 25,000 acre-feet now under lease to permanent ownership, and where possible, seeking an additional 35,000 acre-feet of water rights through either acquisitions or other supply sources.
- c. Recharge Initiatives: Actively participate in the Nueces River Basin Feasibility Study and Cibolo Creek Watershed Feasibility Study. Both studies are on-going and contain local and federal partners. In addition, a continued effort will be made with the Edwards Aquifer Authority to activate the recharge credit rules. This project is further described in the section entitled "Edwards Aquifer Recharge Initiatives."
- d. Brackish Groundwater: Accelerate the brackish groundwater desalination project. This project will assist in diversifying overall supplies in the medium-term. The project will generate up to a 22,000 acre-feet facility, with the potential to offset summer "peaks." This project is further described in the section entitled "Brackish Groundwater Desalination Project."
- e. Regional Carrizo: Accelerate the Regional Carrizo project. Staff should reduce the time for a consultant to perform an independent evaluation of the routing and phasing of this project to three (3) months, quickly reapply for the initial permit, and continue to pursue leases. This project is further described in the section entitled "Regional Carrizo Aquifer Projects."

- f. Lower Colorado River Authority-San Antonio Water System: Continue analysis of the feasibility of the Lower Colorado River Authority-San Antonio Water System ("LCRA-SAWS") project. This project is an important option for meeting long-term water needs. However, renegotiation of the existing contract within the project's statutory constraints is necessary to more competitively address cost, control, yield, and the timing of the water delivery. This project is further described in the section herein entitled "Lower Colorado River Authority Project."
- g. Simsboro: Withdraw SAWS' participation in the Simsboro project. Terminate the existing contract with Alcoa in accordance with its terms and use. With respect to the SAWS-owned water rights, the staff should explore the possible use or disposition of these rights, as opportunity allows.
- h. Lower Guadalupe Water Supply Project: End SAWS' participation in the Lower Guadalupe Water Supply Project due to the continued uncertainty with the surface water and groundwater regulatory environment of the project area.
- i. Recycle Water: Develop a recycle water business plan. The business plan will address how to increase our contractual usage, obtain additional contracts, and evaluate the implication of an ordinance what would require mandatory connections for certain customer classes. This project is further described in the section entitled "Water Reuse Program."
- j. Aquifer Storage & Recovery: Maximize SAWS' Edwards Aquifer storage and the allowable acreage of SAWS' local Carrizo production. This project is further described in the section entitled "Bexar County Aquifer Storage and Recovery."
- k. Other Potential Projects: Continue evaluations of other potential water supply projects, including by not limited to: Coastal Desalination, Recharge and Recirculation, Mesa Water Supply Project, Trinity Aquifer, and the Western Edwards Aquifer water projects.

Combined, these actions enable SAWS to provide affordable, diversified, and sufficient water supplies to meet demand in Planning Scenario 2.

Edwards Aquifer Recharge Initiatives

Recharge Dams are structures that retain rainfall runoff water for short periods of time over the Edwards Aquifer Recharge Zone. Recharge dams retain storm runoff and retain it long enough to allow for a larger volume of water to enter into the Edwards Aquifer. During storm events, storm runoff flows at a faster rate than what can be taken by the recharge features located in the stream channels. The recharge dam allows for a longer retention for more water to filter into the Edwards Aquifer thus increasing recharge amounts.

The Nueces, San Antonio, and Guadalupe River Basins are favorable for development of recharge projects. Of the three basins, the Nueces Basin is the most prolific in terms of recharge effectiveness. With assistance from the U.S. Army Corps of Engineers, studies are currently under way within the Cibolo Creek Watershed and the Nueces River Basin. The results of these studies will identify which sites will have the most potential for recharge enhancement. With the recharge structures tentatively identified, the System is planning on a sustained yield of 13,400 acre-feet per year.

Oliver Ranch and BSR Projects

The System reached a milestone in February 2002 with the introduction of the first non-Edwards Aquifer drinking water supply from the Lower Glen Rose/Cow Creek formation of the Trinity Aquifer in northern Bexar County. The System has contracted for delivery of approximately 5,000-acre feet per year of non-Edwards Aquifer 5groundwater from the Trinity Aquifer from two properties located in northern Bexar County. The construction cost to produce and deliver this water supply is approximately \$5.8 million. Initial delivery of water from the Oliver Ranch project began in February 25, 2002 with BSR production in July 2003. The project was fully operational in June 2004 with the connection of BSR wells 3 and 4 to the System's distribution system.

Western Canyon Project

The System, the San Antonio River Authority ("SARA"), Guadalupe-Blanco River Authority ("GBRA"), and Bexar Metropolitan Water District ("Bexar Met") are working together on the Western Canyon Project for the delivery of water from Canyon Lake. The System will initially receive approximately 8,500 acre-feet per year for service to northern Bexar County. The long-term minimum yield will be 3,950 acre-feet per year. GBRA is required under the contract to divert, treat, and deliver the water to a certain point into the System's delivery system. The permit was issued by the state's regulatory agency, the TCEQ. The project design work has been completed and notice to proceed on construction of various project components took place during the fourth quarter 2004 and first quarter of 2005. Construction of this project is nearing completion, and it is expected that the System will begin receiving water in early 2006.

Brackish Groundwater Desalination Project

The 2005 Update of the System's fifty-year Water Resource Plan includes a recommendation that the System develop a brackish groundwater desalination project. This project involves the development of a moderately sized (up to 22,000 acre-feet) water supply facility with the potential to offset summer "peaks." Hydrologic research on the feasibility of locating this facility in southern Bexar County will begin in December 2005. This analysis will be accompanied by an evaluation of the potential benefit and feasibility of applying innovative procurement methods, such as Design Build Operate and Build Own Operate Transfer strategies to bring this project to on line by 2010.

Regional Carrizo Aquifer Projects

The System is refining plans for delivery and treatment of approximately 20,000 through 56,200 acre-feet of ground water from the Carrizo Aquifer in Gonzales and Wilson Counties. The System is currently undertaking a review process to determine the preferred routing of pipeline associated with the delivery and integration of the Carrizo water into the existing distribution system. Upon completion of this evaluation, which is expected in early 2006, additional construction on this project is scheduled to commence. The project will be developed in phases. The delivery of water from the first phase (22,600 AF) is anticipated in early 2009. Phase II and Phase III are scheduled to be delivered in 2012 and 2016, respectively.

Lower Colorado River Authority Project

The LCRA-SAWS project would conserve and develop up to 330,000 acre-feet of water per year. Of that, approximately 180,000 acre-feet per year of agricultural and other rural water needs would be met in the Colorado basin through conservation of agricultural irrigation water, storage of river water, and supplemental groundwater for agricultural use. Up to 150,000 acre-feet per year of river water would be transferred to the San Antonio area for an eighty-year period.

In February 2001, a Memorandum of Agreement with LCRA outlining the terms for a future binding contract for up to 150,000 acre feet of surface water per year from the Lower Colorado River Basin was signed. That same year, legislation was passed to authorize LCRA to sell water outside its statutory boundary to the System. The System and LCRA have now executed a definitive agreement outlining LCRA's and the System's obligations consistent with the memorandum of Agreement. The System and LCRA are now entering the third year of an estimated seven-year study period to assess the environmental, engineering, and cost impacts.

Bexar County Aquifer Storage and Recovery

An Aquifer Storage and Recovery ("ASR") project involves injecting ground water into an aquifer, storing it and later retrieving it for use. Essentially this is storage that is additionally provided through surface water reservoirs. The System began study of an ASR project in 1996, acquired approximately 3,200 acres in southern Bexar County and has essentially completed the construction of Phase I of the ASR Project. This phase of the project, with a total cost of approximately \$125 million, gives the System the capability of injecting and recovering 30 million gallons per day of Edwards Aquifer water and integrating it into SAWS' existing distribution system. Phase II of the ASR Project is designed to increase the injection, storage, and recovery capacity of the project to 60 million gallons per

day and extend the integration into SAWS' existing distribution system. This phase of the project is currently underway and is anticipated to be complete by the end of 2007.

This project is primarily designed to optimize use of water from the Edwards Aquifer and reduce frequency and duration of critical periods. Additionally, the ASR project may produce "native" groundwater from the project area for use throughout the service areas. In December 2002, the Evergreen Underground Water Conservation District and the System approved an Aquifer Protection and Management Agreement. This agreement ensures operation of the ASR site if the property is annexed in to the district, manages groundwater production, and commits the System to monitoring water levels and mitigation of potential negative impacts. As of December 2005, approximately 17,000 acre-feet of water has been stored in the ASR facility.

Water Reuse Program

The System has developed a water reuse program utilizing high quality effluent from the wastewater treatment process. The System owns the treated effluent from its wastewater treatment plants and has the authority to contract to acquire and to sell non-potable water inside and outside the System's water and wastewater service area. The water reuse system can provide up to 35,000 acre-feet per year for non-potable uses including large scale irrigation and industrial purposes. Once developed to its maximum planned capacity, the System could convert approximately 20% of SAWS current demand for Edwards aquifer water to non-potable uses, thereby making more Edwards water available for potable use. Currently, approximately 19,000 acre-feet of water is under commitment.

In addition to the 35,000 acre-feet per year for irrigation and industrial non-potable uses, the System currently has a contract through 2030 to provide 45,000 acre-feet per year of reuse water to CPS Energy for cooling of electrical generation systems at Braunig and Calaveras lakes. The combined availability of 80,000 acre-feet per year makes this the largest water reuse system in the country. Under the terms of the contract, CPS Energy holds contingent option rights on an additional 10,000 acre-feet of reuse water. These option rights are broken down into two 5,000 acre-feet increments, with the first such option to be exercised no later than June 30, 2007 and the second such option to be exercised no later than June 30, 2011. The revenues derived from the CPS Energy contract have been excluded from the calculation of Gross Revenues and not included in any transfers to the City.

Conservation

Beginning in 1994, the System progressively implemented aggressive water conservation programs, which have reduced total water production and use by 43.2%, from 213 gallons per person per day ("gaped") in 1994 to approximately 130 gaped in 2004. Given these accomplishments, the 2005 update to the System's fifty-year Water Resource Plan set a new goal for conservation that includes the provision that we reduce per capital consumption to 116 gpcd during normal-year conditions and 122 gpcd during dry-year conditions by 2016. This will be accomplished through a variety of means including implementation of the City's water conservation ordinance (Ordinance 100322, passed January 20, 2005), pricing, education, and rebates for water efficient technologies; and system improvements to prevent water loss and other measures.

Indoor Residential Conservation

Indoor residential conservation programs encourage customers to save water inside their homes. A variety of education and rebate incentive programs assist ratepayers in achieving conservation. One example is the Season to Save Community Challenge, which started as an experimental program to test the idea that non-profit organizations would be effective at motivating ratepayers to participate in toilet distribution programs. An incentive is paid to non-profit organizations for finding qualified customers who pick up free toilets during a distribution event. Non-profit groups also receive a bonus for the conservation achieved by customers they helped qualify for the program. The bonus provides incentives for non-profit representatives to ask their participants to install the new toilets quickly.

Another example of the System's conservation program is Plumbers to People, which provides leak repairs and retrofits to qualified low-income homeowner customers. The System, in cooperation with the City of San Antonio's Community Action Division (CAD), qualifies applicants based on the current Federal Assistance Guidelines. Only leaks that result in a loss of potable water are eligible for repair under this program. Water conservation is achieved

by quickly repairing leaks that would otherwise continue due to the cost of repairs. Analysis of program costs and water savings indicate that this affordability program is one of our most effective at conserving water at a reasonable cost per unit.

Customers learn about these programs through the System's website, public events, direct mail inserts in bills, paid advertisements and educational materials in popular local periodicals.

Outdoor Residential Conservation

The System's residential outdoor programs focus on the landscape and irrigation practices of homeowners. Outdoor use can account for up to 50% of total residential water use in the summers and average 20% of the water use annually. Education programs help ratepayers understand how following best practices can save water and money.

Irrigation Check-Ups provide the System's ratepayers with a free analysis of their in-ground irrigation system. Trained Conservation Technicians visit homes to review each component of irrigation systems to determine maintenance needs to make suggestions for improving efficiency.

Seasonal Irrigation Program ("SIP") is a free information service provided to customers who want expert advice on how to water their lawns. The irrigation advice is based on evapotranspiration ("ET") data calculated from a local weather station. Horticulture experts from the Texas Cooperative Extension use the ET data to make weekly irrigation recommendations for recommended grass varieties. Customers receive the advice through e-mail, recorded phone message, the local newspaper, a SIP hotline, or the System's web site.

WaterSaver Landscape Rebate guidelines were changed in 2003 to address concerns that the old program was not maximizing water conservation opportunities. Program changes included the requirement that the entire landscape be drought tolerant, a maximum 50% of landscape in grass, and a mandatory irrigation system check if an irrigation system was present. Higher rebates were given to customers who preserved native landscape during home construction or who did not install a permanent irrigation system. An incentive to meet water conservation expectations was included in the program as well. Customers using a reasonable amount of water during the first year after getting their rebate will receive a small nursery gift certificate. This program is marketed through neighborhood associations, local nurseries, the Garden Volunteers of South Texas and through the Greater San Antonio Builder's Association.

Commercial and Industrial Programs

The System has been working closely with commercial customers to help them conserve water for several years. In 1998, the commercial and industrial programs were expanded to include the toilet retrofit rebates previously offered only to residential customers. Water audits and case-by-case rebates for large-scale retrofits are also available. Since 1996, car wash businesses that meet certain conservation criteria are certified and provided a sign to be posted on their place of business. Every year the System presents the WaterSaver Awards to recognize businesses, organizations, and/or individuals that voluntarily initiated water conservation practices.

Agricultural Conservation and Irrigation Efficiency

The System has been successful in developing partners throughout the region as well as with federal agencies through cost-share programs. The amount of \$500,000 for fiscal year has been appropriated by the United States Department of Agriculture ("USDA") for the Edwards Aquifer region to assist landowners with agricultural irrigation efficiencies. The System has partnered with the USDA and farmers to acquire efficient irrigation systems in exchange for Edwards Aquifer water rights. The System is also currently working with the United States Army Corps of Engineers, the Natural Resource Conservation Service and other local sponsors on programs designed to enhance recharge of the Edwards Aquifer through impoundment structures and brush management.

Capital Improvement Plan

The following is a proposed five-year Capital Improvement Program for SAWS. It is the intention of SAWS to fund the program with tax-exempt commercial paper, impact fees, system revenues, and future bond issues. SAWS budgeted the following capital improvement projects during calendar year 2006:

- \$2 million is budgeted for the wastewater treatment program to repair, replace, upgrade, or expand treatment facilities;
- \$28 million is budgeted for the wastewater collection program to fix deteriorated components of the collection system ;
- \$19 million is budgeted to replace sewer and water mains;
- \$44 million is budgeted for the governmental replacement and relocation program;
- \$2 million is budgeted to construct new production facilities; and
- \$79 million is budgeted for water supply development, water treatment, and water transmission projects for new sources of water.

SAWS anticipates the following capital improvement projects for the five fiscal years listed:

	Fiscal Year Ended December 31,					
	2006	2007	2008	2009	2010	Total
Heating and Cooling	\$ 250,000	\$ 950,000	\$ 800,000	\$ 900,000	\$ 300,000	\$ 3,200,000
Water Delivery	51,059,000	52,920,475	54,508,090	56,143,332	57,827,632	272,458,529
Wastewater	65,306,641	63,778,525	65,691,880	67,662,637	69,692,516	332,132,199
Water Supply	82,269,000	73,480,000	101,640,000	88,106,700	98,734,900	444,230,600
Total	<u>\$ 198,884,641</u>	<u>\$ 191,129,000</u>	<u>\$ 222,639,970</u>	<u>\$ 212,812,669</u>	<u>\$ 226,555,048</u>	<u>\$ 1,052,021,328</u>

Source: SAWS. Project Funding Approach

The following table was prepared by SAWS staff based upon information and assumptions it deems reasonable, and shows the projected financing sources to meet the projected capital needs.

	Fiscal Year Ended December 31,					
	2006	2007	2008	2009	2010	Total
Revenues	\$ 26,538,876	\$ 50,262,978	\$ 24,160,707	\$ 28,296,775	\$ 38,560,669	\$ 167,820,005
Impact Fees	16,708,486	9,899,773	10,048,270	10,198,994	10,351,979	57,207,502
Debt Proceeds	155,637,279	130,966,249	188,430,993	174,316,900	177,642,400	826,993,821
Total	<u>\$ 198,884,641</u>	<u>\$ 191,129,000</u>	<u>\$ 222,639,970</u>	<u>\$ 212,812,669</u>	<u>\$ 226,555,048</u>	<u>\$ 1,052,021,328</u>

Source: SAWS.

Recent Financial Transactions

In December 2005, SAWS issued \$298,220,000 "City of San Antonio, Texas Water System Revenue Refunding Bonds, Series 2005", to advance refund the "City of San Antonio, Texas Water System Revenue and Refunding Bonds, Series 1999" and certain outstanding commercial paper notes.

On May 15, 2006, SAWS refunded \$68,000,000 "City of San Antonio, Texas Water System Revenue Improvement and Refunding Bonds, Series 1996" with the issuance of Tax-Exempt Commercial Paper. The refunding effectively converted the \$68,000,000 of fixed rate bonds into lower coupon variable-rate debt. Total savings from the refunding will depend on future interest rates.

San Antonio Water System Summary of Pledged Revenues for Debt Coverage ¹

	Fiscal Year Ended December 31, 2005	Fiscal Year Ended December 31, 2004	Fiscal Year Ended December 31, 2003	Fiscal Year Ended December 31, 2002	12 Months Ended December 31, 2001 ²
<u>Revenues</u>					
Water System	\$ 93,419,939	\$ 72,888,054	\$ 65,163,910	\$ 58,873,352	\$ 79,451,701
Water Supply	108,045,245	78,546,461	76,044,416	76,167,052	36,684,084
Wastewater System	113,333,959	99,224,713	87,683,794	89,312,338	87,438,542
Chilled Water and Steam	13,370,759	12,027,528	12,193,646	10,871,599	12,899,862
Non Operating Revenues	11,167,861	7,060,677	7,308,979	7,547,353	15,103,714
Adjustments for Pledged Revenues	<u>(6,668,991)</u>	<u>(5,437,557)</u>	<u>(5,591,341)</u>	<u>(7,583,370)</u>	<u>(5,911,934)</u>
Total Revenues	<u>\$332,668,772</u>	<u>\$264,309,876</u>	<u>\$242,803,404</u>	<u>\$235,188,324</u>	<u>\$225,665,969</u>
Maintenance and Operating Expenses	<u>\$173,489,890</u>	<u>\$153,859,964</u>	<u>\$152,742,554</u>	<u>\$138,212,615</u>	<u>\$134,616,252</u>
Net Available for Debt Service	<u>\$159,178,882</u>	<u>\$110,449,912</u>	<u>\$ 90,060,850</u>	<u>\$ 96,975,709</u>	<u>\$ 91,049,717</u>
Maximum Annual Debt Service Requirements - Total Debt ³	\$ 94,992,353	\$ 84,941,122	\$ 76,075,114	\$ 66,267,591	\$ 65,767,934
Maximum Annual Debt Service Requirements - Senior Lien Debt ³	\$ 78,372,649	\$ 67,203,188	\$ 61,511,375	\$ 61,511,375	\$ 55,236,354
Coverage of Total Debt	1.68 X	1.30 X	1.18 X	1.46 X	1.38 X
Coverage of Senior Lien Debt	2.03 X	1.64 X	1.46 X	1.58 X	1.65 X

¹ Unaudited.

² On April 3, 2001, the SAWS Board approved the changing of the fiscal year from a year-end of May 31 to December 31. Report is for the twelve (12) months ending December 31, 2001.

³ As of the end of the fiscal year shown, excludes Tax Exempt Commercial Paper.

Source: SAWS.

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The Airport System

General

The City's airport system consists of the San Antonio International Airport (the "International Airport" or the "Airport") and Stinson Municipal Airport ("Stinson") (the International Airport and Stinson, collectively, the "Airport System"), both of which are owned by the City and operated by its Department of Aviation (the "Department").

The International Airport, located on a 2,600-acre site that is adjacent to Loop 410 and U.S. Highway 281, is approximately eight miles north of the City's downtown business district. The International Airport consists of three runways with the main runway measuring 8,502 feet and able to accommodate the largest commercial passenger aircraft. Its two terminal buildings contain 24 second-level gates. Presently, domestic air carriers providing service to San Antonio are America West, American, American Eagle, Atlantic Southeast, Chautauqua, Comair, Continental, Delta, Frontier, Mesa, Midwest, Northwest, Skywest, Southwest, and United. Mexicana and Aerolitoral are Mexican airlines that provide passenger service to Mexico. The Airport Master Plan design allows for an increase from 24 to 55 gates. It is estimated that current gate facilities are being used at 88% of capacity. A variety of services are available to the traveling public from approximately 245 commercial businesses, including nine rental car companies, which lease facilities at the International Airport and Stinson Municipal Airport.

Stinson, located on 300 acres approximately 5.2 miles southeast of the City's downtown business district was established in 1915 and is one of the country's first municipally owned airports. It is today, the second oldest continuously operating airport in the United States, and is the FAA's designated general aviation reliever airport to the International Airport. An Airport Master Plan for Stinson was initiated in March 2001 to facilitate the development of Stinson and to expand its role as a general aviation reliever to the International Airport. The Texas Department of Transportation accepted the Master Plan in 2002 and has recommended \$16.0 million in grant funding for capital improvements over the next ten to fifteen years. The expansion of Stinson's facilities is also needed to take advantage of new, complimentary business opportunities evolving with the synergy between Brooks City Base, KellyUSA, and the Stinson Airport. A Targeted Industries Study was completed in 2003 as part of the master planning process. The study will help facilitate development of Stinson properties through the identification of industries and businesses considered to be compatible for locating at the Stinson Municipal Airport.

Capital Improvement Plan

General. In order to meet future airport capacity requirements, an Airport Master Plan was completed in 1998. This plan made recommendations to expand terminal and airfield capacity in an orderly manner to coincide with projected growth in passengers and aircraft operations. In fiscal year 2002, the City commenced implementation of a ten-year Capital Improvement Plan (the "CIP"). The CIP is scheduled to conclude in fiscal year 2011; however, due to the terrorist attacks of September 11, 2001, the timing of some projects has been adjusted and the ultimate completion of the plan is expected to extend beyond that date. The CIP addresses both terminal and airfield improvements. The CIP includes the removal of the existing Terminal 2, parts of which are over 50 years old, and the addition of two concourses with corresponding terminal space, public parking facilities, roadway improvements, and extension and improvement to runways along with supporting taxiways and aircraft apron. The capital program over the five-year period from 2005 through 2009 addresses primarily terminal-related improvements, parking roadway improvements, and airfield improvements.

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The anticipated sources of funding for the next five years are as follows:

Funding Sources	Anticipated Funding
Federal Grants	
Entitlements	\$ 27,054,000
General Discretionary	45,105,000
Noise Discretionary	20,867,000
Passenger Facility Charges ("PFCs")	
Pay-As-You-Go	23,301,000
PFCs Secured Bonds	103,156,000
Other Funding	
Airport Funds	29,596,000
Airport Revenue Bonds	<u>91,526,000</u>
Total – All Sources	<u>\$340,605,000</u>

The CIP includes capital improvements, which are generally described as follows:

Improvement	Amount
International Airport	
Terminal/Gate Expansion	\$121,389,000
Airfield Improvements	86,695,000
Cargo Facilities	11,368,000
Roadway Improvements	21,855,000
Parking Improvements	46,865,000
Aircraft Apron	22,504,000
Other (Building Imp., Drainage, etc.)	20,818,000
Stinson Airport	<u>9,111,000</u>
Total	<u>\$340,605,000</u>

Proposed PFC Projects. Public agencies wishing to impose Passenger Facility Charges ("PFC") are required to apply to the Federal Aviation Administration (the "FAA") for such authority and must meet certain requirements specified in the PFC Act and the implementing regulations issued by the FAA.

The FAA issued a Record of Decision on August 29, 2001 approving the City's initial PFC application. The City, as the owner and operator of the Airport, received authority to impose a \$3.00 PFC and to collect approximately \$102.5 million in PFCs. On February 15, 2005, the FAA approved an application amendment which increased PFC funding by a net amount of \$13,893,537. In addition, on February 22, 2005 the FAA approved the City's application for an additional \$50,682,244 in PFCs for 11 new projects.

The City began on November 21, 2001, collecting a \$3.00 PFC (less the \$0.11 air carrier collection charge) per paying passenger enplaned. A total of approximately \$167.1 million in PFC revenues will be required to provide funding for these projects included in the Airport CIP. The City has received PFC "impose and use" authority on all approved projects. The estimated PFC expiration date is April 1, 2016.

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The following projects have been approved as “impose and use”:

- Replace RON (remain overnight) Apron
- Implement Terminal Modifications
- Reconstruct Perimeter Road
- Construct New Concourse B
- Implement Acoustical Treatment Program
- Construct Elevated Terminal Roadway
- Upgrade Central Utility Plant
- Construct Apron
- Install Utilities – Terminal Expansion
- Replace Two ARFF Vehicles
- Conduct Environmental Impact Statement
- Reconstruct Terminal Area Roadway
- Install Noise Monitoring Equipment
- Terminal and Airfield Security
- Install Airfield Electrical Improvements
- PFC Development and Administration Costs

Terminal Renovations. A comprehensive terminal renovation project was completed in 2003 to improve the quality of services provided to passengers at the San Antonio International Airport. The project, which cost approximately \$29 million, included a completely new appearance to the building interiors and provided state-of-art terminal amenities. Included in the terminal renovations was complete redevelopment of the concessions program that provided high-quality retail and food establishments offering a mix of regional and national brands at street prices. Concession space was expanded from 30,000 square feet to over 40,000 square feet. Through the expansion and reconfiguration of concession space, 85% of retail shops and food outlets are now at airside locations. In total, 42 retail, food, and passenger service contracts were awarded. The new concessions program increased revenues to the Airport from \$3.1 million in fiscal year 2002 to \$4.3 million in fiscal year 2004. This represented a 39% gain in two years. On a per-boarding passenger basis, concession revenue went from \$0.86 in fiscal year 2002 to \$1.26 for fiscal year 2004. Following the Airport’s implementation of its new concessions program, it was recognized by the *Airport Revenue News’* “Best Concessions Poll.” The Airport’s concession program was voted for by a panel of judges in the Airport category with less than 4 million enplanements. San Antonio won three first place awards over the last two years. The Airport was honored for having the Terminal with the “Most Unique Services” and “Best Overall Concessions Program” in 2004 and “Best Overall Concessions Program” for 2005. The publication noted the Airport’s high-tech business services, such as high-speed fax and Internet, wireless capabilities and conference rooms. The Best Overall Concessions Program award is given to airports with a convenient customer-friendly layout, good visibility, attractive storefronts, and interesting themes. Also in 2004, *J. D. Power and Associates* announced through its Global Airport Satisfaction Index Study, San Antonio International Airport tied for the highest ranking in customer satisfaction among airports with less than 10 million passengers per year.

Terminal Improvements. The terminal expansion project will include a seven-gate Terminal B and a five-gate Terminal C (expandable up to eleven gates). Terminal B will replace Terminal 2 which is obsolete and will be demolished to make way for Terminal C, as well as further terminal development. Terminal C will be constructed in phases, as passenger growth and demand for gate facilities occur. Site work for the new Terminal has begun, while ground breaking for the building is expected to take place in the spring of 2007. The present Terminal will become Terminal A.

Airfield Improvements. To implement the Master Plan airfield recommendations an Environment Impact Statement (“EIS”) will be required to assess the environmental impacts associated with the capacity enhancing runway/taxiway projects. The EIS process was started by the FAA in 2003; however, depending on the type and timing of the airfield improvements, the initial environmental work may be accomplished through an Environmental Assessment. Public involvement throughout the process is essential to the successful completion of these projects. Airport Master Plan projects to be studied as part of the EIS include extension of Runway 3/21 and Taxiways N and Q; reconstruction and upgrade of Runway 12L/30R and associated taxiways from general aviation to air carrier dimensions (of approximately 8,500 feet by 150 feet), as well as the installation of an instrument landing system.

In order to improve the International Airport's compatibility with its neighbors, two projects have been initiated. In October 2003, work on the installation of a Noise and Operations Monitoring System ("NOMS") began. Federal Airport Improvement Program ("AIP") grant funds will pay for 80% of the NOMS project, with the balance being provided by Airport System self-generated monies. The NOMS is composed of two main systems. These include noise monitoring and flight operations monitoring. The NOMS will closely track aircraft noise exposure in and around particular Airport area neighborhoods or homes and allow the Aviation Department to monitor and implement current and future noise abatement measures. Installation of the NOMS was completed in 2004. The second compatibility project is a Land Use Study which was initiated to assist the City in planning and zoning for future development. Funded in part (80%) by a federal AIP grant, this Study will establish guidelines for managing compatible land uses in areas surrounding the International Airport and Stinson. This Study, which is to be based on existing airport/airfield configurations, includes a public involvement process, which began in the third quarter of 2004.

Parking Improvements. The International Airport operates and maintains approximately 5,810 parking spaces and 1,230 employee parking spaces for a total of 7,040 parking spaces. A parking study was developed in 2001 for the International Airport by AGA Consulting, Inc. The study indicated that projected peak period demand for airport parking will exceed the available supply by the end of 2006. It is estimated that 2,400 additional parking spaces will be required to satisfy projected demand over the next ten years. Future requirements for vehicle parking are currently being addressed with the design of a new garage. The design work is underway with groundbreaking for a new five-story garage, with approximately 2,260 long-term spaces and 660 short-term spaces, planned for early 2007. The associated costs are included in the CIP.

Cargo Improvements. The International Airport has two designated cargo areas: The West Cargo Area, which was constructed in 1974 and refurbished in 1990, and the East Cargo Area, which was completed in 1992 and expanded in 2003. The East Cargo Area is specifically designed for use by all-cargo, overnight-express carriers. Custom-built cargo facilities in the East Cargo Area are leased to Airborne Express and Federal Express, while Eagle Global Logistics constructed a processing facility in the year 2000. In 2005, UPS expanded its facilities by relocating from the West Cargo area to the East Cargo Area. A new belly freight facility is currently under design. Additional land has been allocated to accommodate future growth and an expansion of facilities is currently planned. Foreign trade zones exist at both cargo areas. Enplaned and deplaned cargo for 2004 totaled 133,383 tons.

Airport Operations

General. The City is responsible for the issuance of revenue bonds for the Airport System and preparation of long-term financial feasibility studies for Airport System development. Direct supervision of airport operations is exercised by the Department. The Department is responsible for (i) managing, operating, and developing the International Airport, Stinson, and any other airfields which the City may control in the future; (ii) negotiating leases, agreements, and contracts; (iii) computing and supervising the collection of revenues generated by the Airport System under its management; and (iv) coordinating aviation activities under the FAA.

The International Airport has its own police and fire departments on premises. The firefighters are assigned to duty at the Airport from the City's Fire Department, but their salaries are paid by the Department as an operation and maintenance expense of the Airport System.

The FAA has regulatory authority over navigational aid equipment, air traffic control, and operating standards at both the International Airport and Stinson.

The passage of the Aviation and Transportation Security Act ("ATSA") in November 2001, created the Transportation Security Administration ("TSA"). The Department has worked closely with the TSA to forge a new higher level of security for the traveling public. TSA employs about 300 individuals at the International Airport to meet the new federal security requirements.

The International Airport's explosive detection screening equipment is currently located in the ticket lobby areas of the two terminals. However, the Department is working with the TSA to relocate all baggage screening equipment behind the terminals in new baggage handling systems planned as part of the upcoming Terminal Expansion Project. The City entered into an agreement with the TSA for reimbursements up to \$425,800 for the costs associated with

the use of Airport police officers at the Airport security screening checkpoints in each terminal. The Department also utilizes four Explosive Detection Canine teams. The police officers, assigned with their dogs, provide additional coverage for detection of explosive materials at the Airport in the baggage pickup areas, concourses, parking, cargo, and aircraft. This program is supported by the TSA with reimbursement to the Airport System at \$160,500. The International Airport's coverage is provided in addition to canine support received from the City's Police Department and the Bexar County Sheriff's Office.

The Department has continued to work to improve its security measures. The FAA approved a grant application (80% AIP funding) in 2004 to conduct a security assessment of the International Airport's security program. This project includes an inventory of the existing security measures and an evaluation based on current and anticipated provisions of the ATSA. Recommendations for security enhancements and upgrades could include items such as perimeter fencing, air operations area access points, cargo/belly freight facilities, terminals, fueling areas, concession deliveries, and air traffic control tower.

Comparative Statement of Gross Revenues and Expenses - San Antonio Airport System

The historical financial performance of the Airport System is shown below:

	Fiscal Year Ended September 30				
	2002	2003	2004	2005	2006*
Gross Revenues ¹ :	\$42,377,654	\$43,930,687	\$44,763,847	\$47,180,690	\$52,053,093
Airline Rental Credit	<u>4,468,199</u>	<u>2,612,609</u>	<u>3,486,271</u>	<u>5,322,516</u>	<u>8,107,369</u>
Adjusted Gross Revenues	\$46,845,853	\$46,543,296	\$48,250,118	\$52,503,206	\$60,160,462
Expenses	<u>(22,296,698)</u>	<u>(25,363,607)</u>	<u>(24,164,078)</u>	<u>(26,411,104)</u>	<u>(29,471,318)</u>
Net Income	<u>\$24,549,155</u>	<u>\$21,179,689</u>	<u>\$24,086,040</u>	<u>\$26,092,102</u>	<u>\$30,689,144</u>

* Unaudited

¹ As reported in the City of San Antonio's audited financial statements.

Source: City of San Antonio, Department of Finance.

Total Domestic and International Enplaned Passengers - San Antonio International Airport

The total domestic and international enplaned passengers on a calendar basis, along with year-to-year percentage change are shown below:

Calendar Year	Total	Increase/ (Decrease)	Percent (%) Change
1997	3,484,141	----	----
1998	3,505,372	21,231	0.61
1999	3,538,070	32,698	0.93
2000	3,647,094	109,024	3.08
2001	3,444,875	(202,219)	(5.54)
2002	3,349,283	(95,592)	(2.78)
2003	3,250,911	(98,372)	(2.94)
2004	3,498,972	248,061	7.63
2005	3,713,792	214,820	6.14
2006	4,002,903	289,111	7.79

Source: City of San Antonio, Department of Aviation.

Total Enplaned and Deplaned International Passengers - San Antonio International Airport

The total enplaned and deplaned for international passengers on a calendar basis, along with year-to-year percentage change are shown below:

Calendar Year	Total	Increase/ (Decrease)	Percent (%) Change
1997	200,965	----	----
1998	246,902	45,937	22.86
1999	229,397	(17,505)	(7.09)
2000	243,525	14,128	6.16
2001	219,352	(24,173)	(9.93)
2002	201,274	(18,078)	(8.24)
2003	159,576	(41,698)	(20.72)
2004	191,254	31,678	19.86
2005	185,992	(5,262)	(2.76)
2006	199,138	13,146	7.07

Source: City of San Antonio, Department of Aviation.

Air Carrier Landed Weight - San Antonio International Airport

The historical aircraft landed weight in 1,000-pound units on a calendar year basis is shown below. Landed weight is utilized in the computation of the Airport's landed fee.

Calendar Year	Total	Increase/ (Decrease)	Percent (%) Change
1997	5,530,247	----	----
1998	5,601,616	71,369	1.29
1999	5,778,407	176,791	3.16
2000	5,838,185	59,778	1.03
2001	5,546,561	(291,624)	(5.00)
2002	5,559,018	12,457	0.22
2003	5,391,301	(167,717)	(3.02)
2004	5,416,555	25,254	0.47
2005	5,650,228	233,673	4.31
2006	5,946,232	296,004	5.24

Source: City of San Antonio, Department of Aviation.

* * *

APPENDIX B



CPS ENERGY

**AUDITED FINANCIAL STATEMENTS
FOR THE FISCAL YEARS ENDED
JANUARY 31, 2007 AND 2006
AND INDEPENDENT AUDITORS' REPORT**



MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") serves as an introduction to the financial statements of City Public Service of San Antonio (also referred to as "CPS Energy," "CPS" or the "Company"). It is intended to be an objective and easily understandable analysis of significant financial and operating activities and events for the fiscal year ended January 31, 2007 ("FY 2007"), compared to the fiscal year ended January 31, 2006 ("FY 2006"). It also provides an overview of CPS Energy's general financial condition and results of operations FY 2006 compared to the previous fiscal year ended January 31, 2005 ("FY 2005"). This MD&A has been prepared in accordance with the Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and should be read in conjunction with the financial statements and accompanying notes that follow.

BASIC FINANCIAL STATEMENTS

The Balance Sheets present CPS Energy's assets, liabilities and fund net assets as of the end of each fiscal year. Assets are separated into current and noncurrent categories and are reported in the order of liquidity. Current assets include unrestricted cash and cash equivalents, investments, receivables and inventories, as well as prepayments and other current assets. Noncurrent assets include cash and cash equivalents; investments; and interest receivables that have been restricted by state laws, ordinances or contracts. Noncurrent assets also include prepayments, deferred costs and net capital assets.

Liabilities are also segregated into current and noncurrent categories. Current liabilities include the current maturities of revenue bonds, as well as accounts payable and accrued liabilities. Noncurrent liabilities include net long-term debt, the South Texas Project ("STP") decommissioning trusts' liabilities, deferred revenue and other noncurrent liabilities.

The Balance Sheets report fund net assets as the difference between total assets and total liabilities. The fund net assets are classified as invested in net capital assets, restricted or unrestricted. An unrestricted designation indicates the funds are available for operations.

Within the Statements of Revenues, Expenses and Changes in Fund Net Assets, operating results are reported separately from nonoperating activities, which primarily relate to financing and investing. Contributed capital is also reported separately as a component of the change in fund net assets. These statements identify revenue generated from sales to cover operating expenses. Operating expenses are presented by major cost categories. Revenues remaining are available for debt service, to fulfill city payment commitments, finance capital expenditures and cover contingencies.

The Statements of Cash Flows present operating activities, capital and related financing activities, noncapital financing activities, and investing activities. These statements are prepared using the direct method, which reports cash receipts, along with payments, and presents a reconciliation of operating income to net cash provided by operating activities.

FINANCIAL HIGHLIGHTS AND SIGNIFICANT ACCOUNTING POLICIES

Contributed Capital – Contributions made for construction of capital assets flow through the Statements of Revenues, Expenses and Changes in Fund Net Assets and are shown on the Balance Sheets as part of equity that is invested in capital and other assets. The amount reported for contributed capital was \$22.9 million for FY 2007, as compared with \$63.4 million for FY 2006. The portion of these balances that represents contributions received from customers as payments for utility extensions and services was \$22.4 million for FY 2007 and \$16.4 million for FY 2006. FY 2006 also included contributions received under an agreement with Texas Genco, II L.P. ("Texas Genco") that terminated on January 24, 2006. For additional information regarding this agreement, see the section entitled "Operational Changes."

CPS Energy Component Units – Fund net assets at January 31, 2007, totaled \$3.1 billion, as compared with \$3.0 billion at January 31, 2006. Under GASB Statement No. 14, *The Financial Reporting Entity*, these amounts include the assets and liabilities accumulated for the following:

- City Public Service of San Antonio Disability Income, Group Life Insurance and Group Health Plans ("Employee Benefit Plans") and
- CPS Energy's two decommissioning trusts for STP ("Decommissioning Trusts").

In compliance with the provisions of GASB Statement No. 14, the Employee Benefit Plans and the Decommissioning Trusts (severally and collectively referred to as "component units") are included in CPS Energy's financial statements using the blended method of inclusion, which combines the activity of the component units.

Initially, CPS Energy owned a 28% interest in STP. In May 2005, CPS Energy purchased an additional 12% interest in STP. Assets from an associated decommissioning trust were also received with this purchase. CPS Energy reports the assets in both trusts—the new 12% interest and the original 28% interest—as component units. There were no fund net assets associated with the Decommissioning Trusts for either year since the decommissioning liabilities equaled the assets.

For the Employee Benefit Plans at January 31, 2007, and January 31, 2006, the restricted fund net assets were \$203.1 million and \$178.0 million, respectively. These fund net assets were comprised of cash and cash equivalents, investments and interest receivable, less payables for the Employee Benefit Plans.

STP – Correlating to CPS Energy's 40% interest in STP, the applicable financial results of this nonprofit special-purpose project were fully combined within these financial statements.

Pension Plan – According to the GASB Staff Implementation Guide for GASB Statement No. 14, if an entity is acting in a trustee capacity with regard to its pension plan, the assets of the pension plan should not be evaluated as a potential component unit, but should be reported separately. CPS Energy, through its Oversight Committee and Administrative Committee, acts in a trustee capacity for the Pension Plan. Therefore, consistent with the GASB Statement No. 14 Implementation Guide, the Pension Plan has not been categorized as a component unit of CPS Energy. Accordingly, the financial statements of the Pension Plan are separately audited and reported, and those financial results are not included herein except for certain disclosures provided in Note 8 – Employee Pension Plan.

Securities Lending – CPS Energy, the 28% Decommissioning Trust and the 12% Decommissioning Trust began engaging in securities lending transactions in FY 2007 under a contract with their lending agent, Frost National Bank. GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending

transactions. This guidance includes reporting certain securities lending collateral on the Balance Sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

The City of San Antonio – CPS Energy is a municipal utility owned by the City of San Antonio, Texas (“City”). In turn, CPS Energy is treated as a component unit of the City, which has a financial year that ends September 30.

Summary of Revenues, Expenses and Changes in Fund Net Assets

(In thousands)

	Fiscal Year Ended January 31,			Change			
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005		
Revenues and nonoperating income							
Electric	\$ 1,515,746	\$ 1,437,798	\$ 1,220,874	\$ 77,948	5.4%	\$ 216,924	17.8%
Gas	254,340	244,921	201,531	9,419	3.8%	43,390	21.5%
Total operating revenues	1,770,086	1,682,719	1,422,405	87,367	5.2%	260,314	18.3%
Nonoperating income, net	121,694	57,219	47,547	64,475	112.7%	9,672	20.3%
Total revenues and nonoperating income	1,891,780	1,739,938	1,469,952	151,842	8.7%	269,986	18.4%
Expenses							
Operating expenses							
Fuel, purchased power and distribution gas	659,839	638,636	492,198	21,203	3.3%	146,438	29.8%
STP operation and maintenance	115,269	101,735	72,164	13,534	13.3%	29,571	41.0%
Other operation and maintenance	260,569	242,963	243,089	17,606	7.2%	(126)	-0.1%
Employee benefit plans	25,513	27,820	23,673	(2,307)	-8.3%	4,147	17.5%
Regulatory assessments	28,645	37,083	42,076	(8,438)	-22.8%	(4,993)	-11.9%
Decommissioning	32,721	10,207	13,365	22,514	220.6%	(3,158)	-23.6%
Depreciation and depletion	262,375	246,410	236,686	15,965	6.5%	9,724	4.1%
Total operating expenses	1,384,931	1,304,854	1,123,251	80,077	6.1%	181,603	16.2%
Nonoperating expenses							
Interest and debt-related	156,862	153,573	143,241	3,289	2.1%	10,332	7.2%
Payments to the City of San Antonio	235,898	227,178	194,901	8,720	3.8%	32,277	16.6%
Total nonoperating expenses	392,760	380,751	338,142	12,009	3.2%	42,609	12.6%
Total expenses	1,777,691	1,685,605	1,461,393	92,086	5.5%	224,212	15.3%
Income before other changes in fund net assets	114,089	54,333	8,559	59,756	110.0%	45,774	534.8%
Other transfers to the City of San Antonio	(9,594)	(8,639)	-	(955)	11.1%	(8,639)	-
Contributed capital	22,857	63,421	47,666	(40,564)	-64.0%	15,755	33.1%
Adjustment for STP pension cost	1,505	(177)	-	1,682	-950.3%	(177)	-
Change in fund net assets	128,857	108,938	56,225	19,919	18.3%	52,713	93.8%
Fund net assets – beginning	2,994,539	2,885,601	2,829,376	108,938	3.8%	56,225	2.0%
Fund net assets – ending	\$ 3,123,396	\$ 2,994,539	\$ 2,885,601	\$ 128,857	4.3%	\$ 108,938	3.8%

RESULTS OF OPERATIONS

Total Revenues and Nonoperating Income

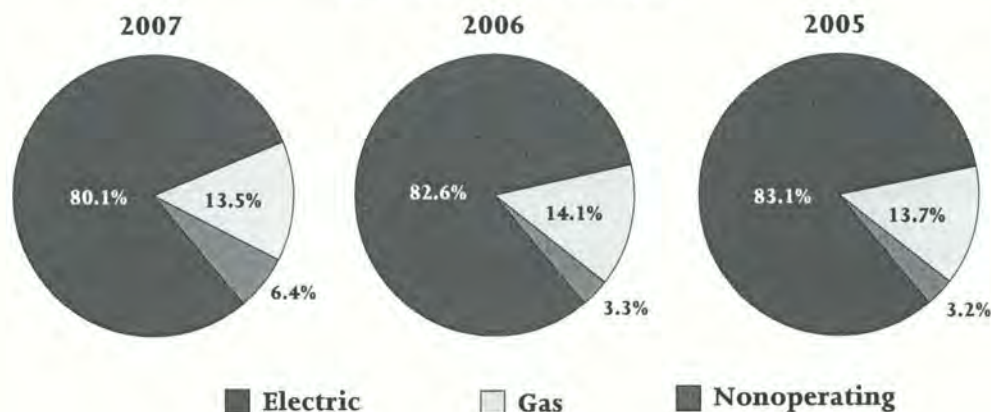
FY 2007 – Representing 93.6% of total revenues and nonoperating income, electric and gas revenues of \$1.8 billion increased by \$87.4 million, or 5.2%, compared to FY 2006. Additionally, CPS Energy had \$121.7 million in net nonoperating income for FY 2007 compared to \$57.2 million for FY 2006.

Electric energy is generated from several fuel sources—coal, nuclear and gas, with some purchased energy, including wind. Comprising 80.1% of CPS Energy’s total revenues and nonoperating income, electric revenue of \$1.5 billion increased 5.4% from FY 2006. This was due primarily to increases of \$49.2 million in system nonfuel recoveries, \$24.5 million in off-system nonfuel recoveries, and \$15.7 million in off-system fuel recoveries. These increases were partially offset by a decrease of

\$11.9 million in regulatory recoveries. Nonfuel electric recoveries rose due to a 10.2% increase in electric sales as a result of higher usage per customer due to warmer summer weather, as well as customer growth. The number of electric customers increased 23,130, from 639,001 at January 31, 2006, to 662,131 at January 31, 2007.

Total Revenues and Nonoperating Income

Fiscal Year Ended January 31,



Representing 13.5% of total revenues and nonoperating income, gas revenue for FY 2007, totaled \$254.3 million, a 3.8% increase from FY 2006. The increase was due primarily to a gas rate adjustment that became effective June 26, 2006, as well as an increase in sales and related nonfuel recoveries. Gas sales totaled 22.4 million MCF for FY 2007, compared to 21.1 million MCF for FY 2006, as colder winter weather increased customer usage. Gas fuel recoveries also rose due to the higher sales, while the unit cost for gas decreased 4.1%. Additionally, the gas customer base increased by 3,925 to 314,785.

Net nonoperating income of \$121.7 million increased \$64.5 million from FY 2006. This increase was mostly due to higher interest income resulting from a greater level of invested funds and higher yields. Total nonoperating income for FY 2007 was reported net of expenses of \$2.1 million that were incurred to support property rental and other miscellaneous services.

FY 2006 – Representing 96.7% of total revenues and nonoperating income, electric and gas revenues of \$1.7 billion increased by \$260.3 million, or 18.3%, compared to FY 2005. Additionally, CPS Energy had \$57.2 million in net nonoperating income for FY 2006 compared to \$47.5 million the previous fiscal year.

Representing 82.6% of CPS Energy's total revenues and nonoperating income, electric revenue of \$1.4 billion increased 17.8% from FY 2005. This was due primarily to increases of \$111.2 million in system fuel recoveries, \$80.9 million in system nonfuel recoveries, and \$37.2 million in off-system fuel and nonfuel recoveries. A rise in gas costs was a significant factor in higher fuel recovery revenue. In addition, overall electric sales increased 6.6% as a result of higher usage per customer due to hotter weather and customer growth. The number of electric customers increased 21,003, from 617,998 at January 31, 2005, to 639,001 at January 31, 2006.

Representing 14.1% of total revenues and nonoperating income, gas revenue for FY 2006 totaled \$244.9 million, a 21.5% increase from FY 2005. The increase was due primarily to fuel cost recoveries as a result of a 33.8% increase in the unit price. Gas sales totaled 21.1 million MCF compared to

22.4 million MCF for FY 2005. Gas customers at January 31, 2006, totaled 310,860, an increase of 2,304 from the prior fiscal year.

Net nonoperating income of \$57.2 million increased \$9.7 million from FY 2005. This increase was mostly due to higher interest income resulting from a greater level of invested funds and higher yields. Total nonoperating income for FY 2006 was reported net of expenses of \$1.7 million that were incurred to support property rental and other miscellaneous services.

Operating Expenses

FY 2007 – Operating expenses totaled \$1.4 billion and were \$80.1 million, or 6.1%, higher than FY 2006.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$659.8 million increased by \$21.2 million. Electric fuel and purchased power increased by \$17.3 million to \$485.0 million, as generation requirements were 10.7% higher due to greater usage per customer and a larger customer base. Relative to distribution gas, costs increased \$3.9 million to \$174.8 million as gas purchases increased 6.7% based on greater usage per customer and more gas customers.

STP operation and maintenance expenses for FY 2007 were \$115.3 million, or \$13.6 million higher than FY 2006, as CPS Energy increased its ownership in STP in May 2005 by acquiring an additional 12%, thus increasing its share of costs and reflecting a full year of ownership.

Other operation and maintenance expenses for FY 2007 were \$260.6 million, or \$17.6 million higher than FY 2006 due to higher costs necessary to serve the greater customer base.

The costs of the Employee Benefit Plans for FY 2007 decreased \$2.3 million from FY 2006 to \$25.5 million due to higher employee contributions.

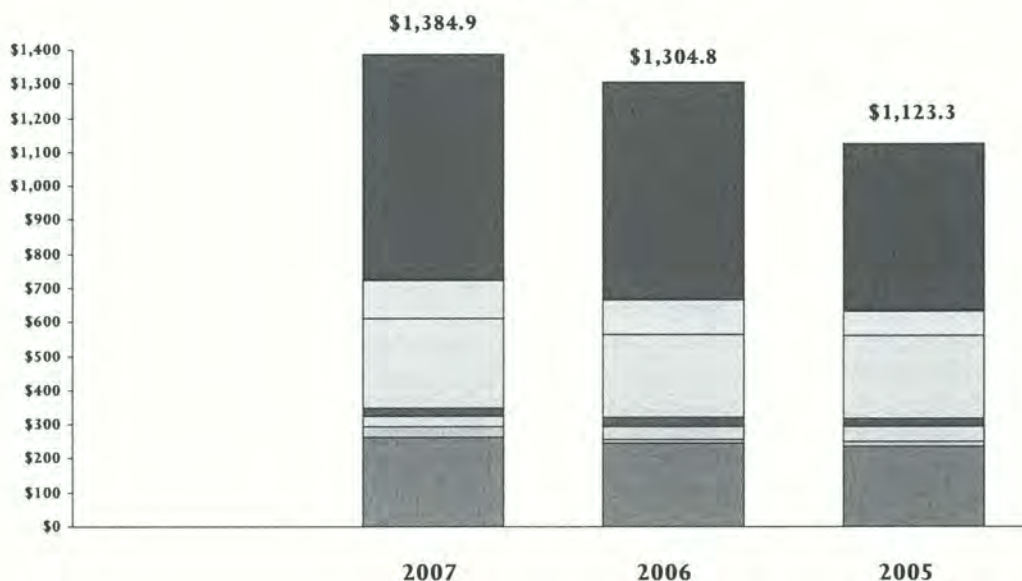
Regulatory assessments were \$28.6 million for FY 2007, a decrease of \$8.5 million, or 22.8%, compared to FY 2006. Electric Reliability Council of Texas ("ERCOT") related costs decreased \$14.8 million, including decreases for Reserve Service fees and Out of Merit Replacement Capacity and Energy charges, along with higher credits for Reserve Uplift charges and Transmission Congestion Rights Auction Credits. Partially offsetting the ERCOT decreases was an increase of \$6.3 million in the Public Utility Commission of Texas ("PUCT") Transmission Costs of Service ("TCOS") payments.

In January 2007, the PUCT approved CPS Energy's application to change its rates for wholesale transmission service. Due to an increase in capital projects, CPS Energy's newly approved transmission revenue requirements of \$94.9 million, which were based on FY 2006 data, are significantly higher than the previously approved transmission revenue requirements of \$59.8 million, which were based on the data from the fiscal year ended January 31, 2003.

Decommissioning expenses totaled \$32.7 million in FY 2007 and were \$22.5 million higher than FY 2006. Due to the zero fund net assets of the decommissioning trusts, the increase in decommissioning expenses are directly related to the increases in investment income of the two trusts.

Depreciation and depletion expense of \$262.4 million for FY 2007 was \$16.0 million higher than FY 2006. This primarily reflected capital additions, which included a full year of the 12% STP ownership purchase, various substation and transmission line projects, and a baghouse installation.

Total Operating Expenses
Fiscal Year Ended January 31,
(In millions)



	2007	2006	2005
Fuel, purch. power & dist. gas	\$ 659.8	\$ 638.6	\$ 492.2
STP operation & maintenance	115.3	101.7	72.1
Other operation & maintenance	260.6	243.0	243.1
Employee benefit plans	25.5	27.8	23.7
Regulatory assessments	28.6	37.1	42.1
Decommissioning	32.7	10.2	13.4
Depreciation and depletion	262.4	246.4	236.7

FY 2006 – Operating expenses totaled \$1.3 billion. These expenses were \$181.5 million, or 16.2%, higher than FY 2005.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$638.6 million increased by \$146.4 million, or 29.8%. Electric fuel and purchased power increased by \$109.5 million to \$467.7 million, reflecting higher electric generation requirements caused by hotter weather as indicated by a 16.1% increase in cooling-degree days. In addition, the average unit price per MWh was 23.1% higher than FY 2005 primarily due to increases in the price of gas and a higher level of gas-fueled electric generation. Relative to distribution gas, costs increased \$36.9 million to \$170.9 million, as the average unit cost increased 33.8%. Partially offsetting the unit cost increase was a 4.6% decrease in the volume of distribution gas purchases, as usage per customer decreased 6.0%, which related to a corresponding decrease in heating-degree days.

STP operation and maintenance expenses for FY 2006 were \$101.7 million, or \$29.6 million higher than FY 2005, as CPS Energy increased its ownership in this nuclear operating company in May 2005 by acquiring an additional 12%, thus increasing its share of costs. Additionally, there were two planned maintenance outages this year compared to one in the prior fiscal year.

Other operation and maintenance expenses were comparable to the prior year.

The costs of the Employee Benefit Plans for FY 2006 were \$27.8 million, which increased \$4.1 million, or 17.5%, from FY 2005. The increase was due to a higher level of health claims.

Regulatory assessments were \$37.1 million for FY 2006, a decrease of \$5.0 million, or 11.9%, compared to FY 2005. The PUCT TCOS payments were \$3.0 million lower principally due to a two-year refund amount from the Lower Colorado River Authority reported in FY 2006, as well as CPS Energy's TCOS rate adjustment in May 2004 that favorably affected all of FY 2006, but only nine months of FY 2005. Additionally, ERCOT-related costs decreased \$2.0 million, as Transmission Congestion Rights Auction Credits increased while Reserve Must Run Service Fees decreased.

Decommissioning expense totaled \$10.2 million for FY 2006 and was \$3.2 million lower than FY 2005. The decrease in decommissioning expense was primarily due to a lower funding requirement as called for by the decommissioning cost study conducted in June 2004.

Depreciation and depletion expense of \$246.4 million for FY 2006 was \$9.7 million, or 4.1%, higher than FY 2005. This primarily reflected new plant additions, which included the 12% ownership purchase of STP and a new Energy Management Center added late in FY 2005.

Nonoperating Expenses

FY 2007 – Interest and debt-related costs of \$156.9 million were \$3.3 million higher than FY 2006. This was due to additional interest costs on the Senior Lien and commercial paper borrowings completed in August 2006, as well as higher costs on Junior Lien debt that has a variable rate that rose as a result of changes in the market. Also, \$7.2 million in costs for the cash defeasance of debt were incurred in FY 2007. These amounts were partially offset by a higher allowance for funds used during construction ("AFUDC") for projects such as the new J.K. Spruce Unit 2 ("Spruce 2") coal generating plant currently under construction and lower debt amortization costs.

CPS Energy is a wholly owned component unit of the City. In accordance with the Company's bond ordinances, no more than 14% of CPS Energy's gross system revenues can be remitted to the City each year. Payments to the City for FY 2007 totaled \$235.9 million and were 3.8% higher than FY 2006. This reflected the increase in gross revenues subject to City payment, including higher fuel and nonfuel recoveries, and greater nonoperating revenues.

In addition to the City payments noted above, CPS Energy recorded \$9.6 million in other transfers to the City. These additional distributions are separately reported with other changes in fund net assets. After these additional distributions, CPS Energy was still in accordance with its bond ordinances. Distributions to the City were under 14% of the company's gross system revenues.

FY 2006 – Interest and debt-related costs of \$153.6 million were \$10.3 million higher than FY 2005. The interest on the Junior Lien, Variable Rate Demand Obligation ("VRDO") bonds increased as a result of a \$160.0 million bond issue in November 2004 and an increase in market rates over FY 2005. The issuance of \$240.7 million in long-term debt in April 2005, along with the issuance of \$197.3 million in October of that year, caused the interest on Senior Lien debt to increase \$4.4 million. Higher rates caused commercial paper interest to also increase. These increases were partially offset by lower debt-related amortization and a higher level of AFUDC, also known as capitalized interest.

Payments to the City for FY 2006 totaled \$227.2 million and were 16.6% higher than FY 2005. This reflected the increase in gross revenue subject to City payment, including higher electric fuel and nonfuel recoveries, greater nonoperating revenues and increased gas fuel recoveries.

In addition to the City payments noted above, CPS Energy recorded \$8.6 million in other transfers to the City. These additional distributions are separately reported after income from operations. After

these additional distributions, CPS Energy was still in accordance with its bond ordinances. Distributions to the City were under 14% of the company's gross system revenues.

Other Changes In Fund Net Assets

FY 2007 – Income before other changes in fund net assets totaled \$114.1 million for FY 2007, an increase of \$59.8 million from FY 2006. Contributed capital of \$22.9 million was \$40.5 million lower than FY 2006 due to the termination of the Joint Operations Agreement (“JOA”) in January 2006. For additional information, see section titled “Operational Changes.” After recording \$22.9 million in contributed capital, \$9.6 million of additional transfers to the City, and a \$1.5 million STP pension adjustment, CPS Energy's change in fund net assets was \$128.9 million, which was \$20.0 million above last year.

FY 2006 – Income before other changes in fund net assets totaled \$54.3 million for FY 2006, an increase of \$45.8 million from FY 2005. After recording \$63.4 million in contributed capital, \$8.6 million of additional transfers to the City, and an adjustment for STP pension cost of (\$0.2) million, the overall change in fund net assets for the period totaled \$108.9 million compared to \$56.2 million for FY 2005.

FINANCIAL POSITION

Balance Sheets Summary

(In thousands)

	January 31,			Change			
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005		
Assets							
Current assets	\$ 1,294,575	\$ 600,305	\$ 619,597	\$ 694,270	115.7%	\$ (19,292)	-3.1%
Noncurrent assets							
Noncurrent assets - restricted	1,541,002	1,265,556	1,123,716	275,446	21.8%	141,840	12.6%
Other noncurrent assets	514,017	524,408	543,183	(10,391)	-2.0%	(18,775)	-3.5%
Capital assets, net	5,294,792	4,942,636	4,645,994	352,156	7.1%	296,642	6.4%
Total assets	<u>\$ 8,644,386</u>	<u>\$ 7,332,905</u>	<u>\$ 6,932,490</u>	<u>\$ 1,311,481</u>	17.9%	<u>\$ 400,415</u>	5.8%
Liabilities							
Current liabilities	\$ 1,082,821	\$ 391,331	\$ 311,493	\$ 691,490	176.7%	\$ 79,838	25.6%
Long-term debt, net	3,327,551	2,963,596	2,838,892	363,955	12.3%	124,704	4.4%
Other noncurrent liabilities	1,110,618	983,439	896,504	127,179	12.9%	86,935	9.7%
Total liabilities	<u>\$ 5,520,990</u>	<u>\$ 4,338,366</u>	<u>\$ 4,046,889</u>	<u>\$ 1,182,624</u>	27.3%	<u>\$ 291,477</u>	7.2%
Fund net assets							
Invested in capital assets,							
net of related debt	\$ 2,118,261	\$ 1,949,167	\$ 1,821,531	\$ 169,094	8.7%	\$ 127,636	7.0%
Restricted	792,920	847,572	750,495	(54,652)	-6.4%	97,077	12.9%
Unrestricted	212,215	197,800	313,575	14,415	7.3%	(115,775)	-36.9%
Fund net assets	<u>\$ 3,123,396</u>	<u>\$ 2,994,539</u>	<u>\$ 2,885,601</u>	<u>\$ 128,857</u>	4.3%	<u>\$ 108,938</u>	3.8%

Current Assets

FY 2007 – The increase in current assets of \$694.3 million, from \$600.3 million as of January 31, 2006, to \$1.3 billion as of January 31, 2007, was primarily due to \$626.4 million received in securities lending collateral, a \$66.9 million general funds increase due primarily to greater level of invested funds, and a \$34.2 million increase in customer accounts receivable resulting from greater electric and gas customers usage driven by the weather. These increases were partially offset by various decreases, which primarily included a reduction of \$27.0 million in gas inventories resulting from a decrease in gas storage levels and \$15.5 million in lower miscellaneous receivables due mostly to the termination of the JOA.

FY 2006 – The decline in current assets of \$19.3 million, from \$619.6 million as of January 31, 2005, to \$600.3 million as of January 31, 2006, was due to \$75.7 million in general funds used for construction, partially offset by various increases. These increases primarily included a rise in fuel inventories of \$32.0 million principally due to higher fuel commodity prices and CPS Energy's increased interest in STP, an increase in the JOA receivable of \$5.7 million, an increase of \$1.8 million related to hurricane assistance billings, a rise in the prepaid margin fuel account of \$5.5 million for future option calls, and \$15.7 million in additional fuel hedges.

Noncurrent Assets – Restricted

FY 2007 – The increase in noncurrent assets - restricted of \$275.4 million, from \$1.3 billion as of January 31, 2006, to \$1.5 billion as of January 31, 2007, was primarily due to a net increase of \$183.7 million from new bond issue and commercial paper proceeds for capital projects and a \$171.2 million increase in the component units restricted assets, including \$110.0 million received in securities lending collateral for the STP Decommissioning Trust. These increases were partially offset by a decrease of \$83.2 million in the Repair and Replacement Account from funding of capital projects.

FY 2006 – The increase in noncurrent assets - restricted of \$141.8 million, from \$1.1 billion as of January 31, 2005, to \$1.3 billion as of January 31, 2006, was partially due to a net increase of \$86.6 million in the Repair and Replacement Account from additional funding from operations and an \$83.9 million increase in the component units restricted assets, which was primarily due to the purchase of 12% additional ownership in STP. These increases were partially offset by a decrease of \$34.1 million in the Bond Construction Fund from funding of capital projects.

Other Noncurrent Assets

FY 2007 – Other noncurrent assets declined from \$524.4 million as of January 31, 2006, to \$514.0 million as of January 31, 2007. The \$10.4 million decrease related primarily to a June 2000 lease/leaseback transaction for CPS Energy's J.K. Spruce Unit 1 ("Spruce 1") property, whereby \$637.0 million in prepaid rent is being amortized over approximately 32 years. Partially offsetting the \$19.8 million decrease related to the lease/leaseback amortization is a \$6.4 million increase in various long-term receivables and a \$3.0 million increase in STP additional minimum pension liability.

FY 2006 – The decline in other noncurrent assets of \$18.8 million, from \$543.2 million as of January 31, 2005, to \$524.4 million as of January 31, 2006, was related primarily to a June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$637.0 million in prepaid rent is being amortized over approximately 32 years.

Capital Assets, Net

FY 2007 – At January 31, 2007, net capital assets of \$5.3 billion included an increase of \$352.2 million from the amount recorded at the end of FY 2006. Total additions to plant-in-service of \$476.0 million and an increase in construction-in-progress of \$122.8 million, the most significant contributors to this increase, were offset by depreciation and depletion of \$262.4 million. In addition, capitalized nuclear fuel increased by \$10.5 million due to higher purchases than the amount amortized.

Construction on Spruce 2 started on March 21, 2006, with plans for commercial operation in 2010. CPS Energy selected Calaveras Power Partners—a team led by Zachry Construction Corporation of San Antonio—to construct the 750-megawatt coal-fired generating unit at Calaveras Lake. Spruce 2 will be the largest of the four coal units at Calaveras Lake and will be equipped with current emissions-control technology.

Increases in construction-in-progress included expenditures for Spruce 2, J.T. Deely Units 1 and 2 Baghouses, and a new transmission line between CPS Energy's Cagnon substation to the Kendall and Bexar County property line (also referred to as the Cagnon-to-Kendall transmission line). During FY 2007, the J.T. Deely Unit 2 Baghouse and the Cagnon-to-Kendall transmission line were completed and moved into plant-in-service.

Of the total plant-in-service and construction-in-progress additions, \$607.8 million related to new construction and removal costs. These additions were funded from \$246.6 million of tax-exempt bonds, \$173.3 million of tax-exempt commercial paper, \$1.7 million from the Overhead Conversion Fund, \$31.6 million from Contributed Capital, and \$154.6 million from the Repair and Replacement Account.

Net capital assets included reserves for dismantling costs. These reserves are reflected in the credits shown in the Summary of Capital Assets, Net of Accumulated Depreciation table under the categories "Electric plant – Machinery and equipment" and "General plant – Other."

Summary of Capital Assets, Net of Accumulated Depreciation (In thousands)

	January 31,			Change			
	2007	2006	2005	2007 vs. 2006		2006 vs. 2005	
Nondepreciable assets							
Land	\$ 60,080	\$ 58,651	\$ 56,482	\$ 1,429	2.4%	\$ 2,169	3.8%
Nonutility land	12,599	12,599	12,599	-	0.0%	-	0.0%
Construction-in-progress	419,795	296,946	180,594	122,849	41.4%	116,352	64.4%
Total nondepreciable assets	492,474	368,196	249,675	124,278	33.8%	118,521	47.5%
Nuclear fuel	69,976	59,470	35,389	10,506	17.7%	24,081	68.0%
Utility property leased	17,945	18,449	18,449	(504)	-2.7%	-	0.0%
Electric plant							
Buildings and structures	621,558	649,345	625,229	(27,787)	-4.3%	24,116	3.9%
Systems and improvements	3,275,924	3,083,259	3,007,179	192,665	6.2%	76,080	2.5%
Machinery and equipment	(6,506)	(4,054)	(4,297)	(2,452)	60.5%	243	5.7%
Total electric plant	3,890,976	3,728,550	3,628,111	162,426	4.4%	100,439	2.8%
Gas plant							
Buildings and structures	27	27	30	-	0.0%	(3)	-10.0%
Systems and improvements	396,350	383,066	325,071	13,284	3.5%	57,995	17.8%
Total gas plant	396,377	383,093	325,101	13,284	3.5%	57,992	17.8%
General plant							
Buildings and structures	120,978	117,233	120,812	3,745	3.2%	(3,579)	-3.0%
Machinery and equipment	315,657	276,804	277,866	38,853	14.0%	(1,062)	-0.4%
Other	(9,591)	(9,159)	(9,409)	(432)	4.7%	250	2.7%
Total general plant	427,044	384,878	389,269	42,166	11.0%	(4,391)	-1.1%
Total capital assets, net	\$ 5,294,792	\$ 4,942,636	\$ 4,645,994	\$ 352,156	7.1%	\$ 296,642	6.4%

FY 2006 – At January 31, 2006, net capital assets of \$4.9 billion included an increase of \$296.6 million from the amount recorded at the end of FY 2005. Total additions to plant-in-service of \$396.8 million and an increase in construction-in-progress of \$116.4 million were offset by depreciation of \$246.4 million.

The increase in plant-in-service included funding the acquisition of the additional 12% share in STP. Funding was achieved with bond proceeds. Net capital assets also included reserves for dismantling costs. These reserves are reflected in the credits shown in the Summary of Capital Assets, Net of

Accumulated Depreciation table under the categories "Electric plant – Machinery and equipment" and "General plant – Other." Increases in construction-in-progress included expenditures toward the new coal-fired plant, Spruce 2; J.T. Deely Units 1 and 2 Baghouses; and the new Cagnon-to-Kendall transmission line.

Of the total plant-in-service and construction-in-progress additions, \$522.1 million related to new construction and removal costs. These additions were funded from \$276.2 million of tax-exempt bonds, \$75.7 million from general funds, \$1.9 million from the Overhead Conversion Fund, \$51.1 million from Contributed Capital, and \$117.2 million from the Repair and Replacement Account.

Current Liabilities (Excluding Debt)

FY 2007 – Excluding current maturities on long-term debt, current liabilities increased \$684.9 million, from \$256.2 million as of January 31, 2006, to \$941.1 million as of January 31, 2007. The increase was primarily due to \$626.4 million in securities lending obligation, a \$48.7 million increase in amounts for vendor payables due partly to major construction projects, i.e., Spruce 2, and a \$9.5 million increase in natural gas purchase payables. Partially offsetting the increases were reduced Employee Incentive Plan accruals of \$7.5 million and \$4.3 million lower STP operations, maintenance and construction payables.

FY 2006 – Excluding current maturities on long-term debt, current liabilities increased \$72.0 million, from \$184.2 million as of January 31, 2005, to \$256.2 million as of January 31, 2006. The overall rise was due to increases in numerous categories, including the following: elevated vendor payables of \$34.1 million related primarily to construction of the Spruce 2 power plant, increased natural gas purchases of \$14.8 million, a rise in STP operation payable of \$12.1 million due mainly to CPS Energy's larger ownership interest, higher employee-related liabilities of \$9.7 million and an increased payable to the City of \$8.2 million. Partially offsetting the increases were reduced liabilities of \$9.5 million for purchased power.

Other Noncurrent Liabilities (Excluding Debt)

FY 2007 – Excluding the noncurrent portion of debt, long-term liabilities increased \$127.2 million, from \$983.4 million as of January 31, 2006, to \$1.1 billion as of January 31, 2007. This increase was due primarily to a \$110.0 million increase in cash collateral from securities lending for the Decommissioning Trusts and a \$37.1 million increase in STP decommissioning obligation. This increase was partially offset by the June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$ 725.0 million deferred lease revenue is being amortized over 32 years.

FY 2006 – Excluding the noncurrent portion of debt, long-term liabilities increased \$86.9 million, from \$896.5 million as of January 31, 2005, to \$983.4 million as of January 31, 2006. This increase was due primarily to a higher decommissioning obligation of \$78.7 million associated with the added 12% ownership interest in STP. Additional increases resulted from a rise of \$11.3 million in pension-related costs also due to CPS Energy's increased ownership in STP and \$15.8 million in increased fuel hedges. These increases were partially offset by the June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$725.0 million of deferred lease revenue is being amortized over approximately 32 years.

FINANCING AND DEBT COVENANTS COMPLIANCE

Long-Term Debt (Excluding Tax-Exempt Commercial Paper)

FY 2007 – Issuance – On August 31, 2006, CPS Energy issued \$384.2 million of tax-exempt New Series 2006A Revenue Bonds. These bonds were partially used to reimburse the Repair and Replacement Account for construction expenditures incurred during the months of February through July 2006 in the amount of \$131.2 million. The \$268.8 million remaining proceeds and net original issue premium will be used to fund generation, and electric and gas distribution construction projects.

Defeasance – On August 11, 2006, \$106.4 million of New Series 1997 Revenue and Refunding Bonds were legally defeased with cash. Under this defeasance, the debt obligations have been technically voided, as the cash has been escrowed with a third party to service the debt. As a result, an accounting loss of \$7.2 million was recorded. The basis of the loss calculation included \$107.8 million paid for the actual defeasance; less the par value of debt; plus unamortized bond issue, reacquisition and premium/discount costs.

Other Reductions – In addition to the cash defeasance that reduced debt, CPS Energy also made principal payments during the fiscal year.

Summary of Debt Rollforward Activity

(In thousands)

Fiscal Year 2007			
Balance Outstanding February 1, 2006	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2007
\$ 2,967,885	\$ 384,185	\$ (241,215)	\$ 3,110,855

FY 2006 – Issuance – For FY 2006, a total of \$732.6 million in bonds was issued. In October 2005, \$197.3 million in New Series 2005A Revenue Refunding Bonds were issued. These bonds were used to refund \$200.0 million of CPS Energy's outstanding Tax-Exempt Commercial Paper ("TECP").

In April 2005, CPS Energy issued \$294.6 million and \$240.7 million in New Series 2005 Revenue Refunding Bonds and New Series 2005 Revenue Bonds, respectively. The former instruments refunded outstanding revenue bonds for a net present value debt service savings of \$19.7 million, while the latter instruments were issued to fund transmission, electric distribution, information technology and communication, and general property construction.

Redemption – Included in the decreases for the fiscal year was a redemption. On December 1, 2005, CPS Energy opted to redeem \$3.0 million of the 2004 VRDOs' principal and then remarket the remaining \$157.0 million of the bonds for a two-year term at an interest rate of 3.6% per annum.

Other Reductions – In addition to the redemption that reduced debt, CPS Energy also made principal payments during the fiscal year.

Summary of Debt Rollforward Activity

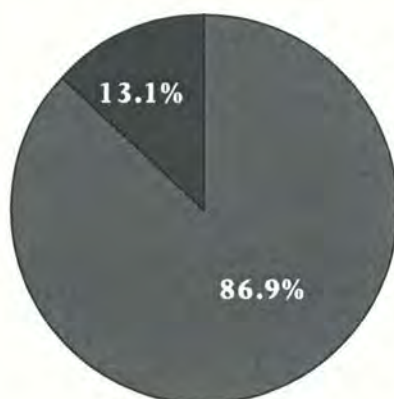
(In thousands)

Fiscal Year 2006			
Balance Outstanding February 1, 2005	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2006
\$ 2,661,225	\$ 732,635	\$ (425,975)	\$ 2,967,885

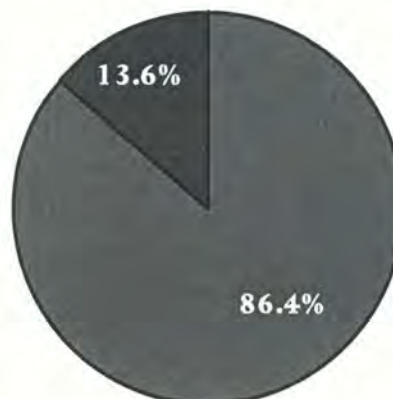
Existing Debt

At January 31, 2007, CPS Energy's total debt was \$3.1 billion, excluding commercial paper. This long-term debt was comprised of \$2.7 billion in fixed-interest-rate instruments and \$407.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt varied from 2.3% on the 2003 tax-exempt bonds to 7.4% on the 2000B taxable bonds, with an overall weighted-average yield of 4.8%. Separately, the variable-rate debt had a blended interest rate of 3.5%. Interest rates on New Series Bonds declined slightly in FY 2007 due to implemented financing strategies and refunding transactions.

**Allocation of Debt
at January 31, 2007**



**Allocation of Debt
at January 31, 2006**



■ Fixed-Rate Instruments ■ Variable-Rate Instruments

Note: Graphs exclude Tax-Exempt Commercial Paper

At January 31, 2006, CPS Energy's total debt was \$3.0 billion, excluding commercial paper. This long-term debt was comprised of \$2.6 billion in fixed-interest-rate instruments and \$407.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt varied from 2.3% on the 2003 tax-exempt bonds to 7.4% on the 2000B taxable bonds, with an overall weighted-average yield of 4.9%. Separately, the variable-rate debt had a blended interest rate of 3.3%.

Tax-Exempt Commercial Paper

CPS Energy maintains a TECP program to provide tax-exempt financing for various purposes. The program is currently authorized to have notes outstanding in an amount not to exceed \$450.0 million. CPS Energy replaced the TECP liquidity facility, effective November 1, 2004, for a three-year term. Effective January 1, 2006, CPS Energy extended the TECP liquidity facility's term to November 1, 2010.

FY 2007 – Issuance – On August 24, 2006, CPS Energy issued \$200.0 million of TECP that will be used to fund generation, as well as electric and gas distribution construction projects.

Summary TECP Rollforward Activity

(In thousands)

Fiscal Year 2007			
Balance Outstanding February 1, 2006	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2007
\$ 150,000	\$ 200,000	\$ -	\$ 350,000

FY 2006 – Redemption – On October 27, 2005, CPS Energy issued \$197.3 million of New Series 2005A Revenue Refunding Bonds to redeem \$200.0 million of the outstanding TECP.

Summary TECP Rollforward Activity

(In thousands)

Fiscal Year 2006			
Balance Outstanding February 1, 2005	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2006
\$ 350,000	\$ -	\$ (200,000)	\$ 150,000

Compliance

With respect to all New Series Bonds outstanding at January 31, 2007, the net revenues of the electric and gas systems ("Systems") are pledged to the payment of principal and interest thereon. All New Series Bonds are issued as Senior Lien Obligations, and the principal and interest thereon have a first lien upon the net revenues of CPS Energy's Systems.

The VRDOs are issued as Junior Lien Obligations. The borrowings from the Junior Lien Obligations are equally and ratably secured by and payable from the net revenues of CPS Energy's Systems, such pledge being subordinate and inferior to the pledge of net revenues securing the Senior Lien Obligations, but prior and superior to the lien on, and pledge of, the net revenues securing the payment of the TECP Notes.

The total amount outstanding of Senior Lien Obligations, including current maturities, was \$2.7 billion at January 31, 2007, and \$2.6 billion at January 31, 2006. The total amount outstanding of Junior Lien Obligations was \$407.0 million at January 31, 2007 and 2006.

The current TECP revolving credit agreement permits CPS Energy to borrow up to an aggregate amount not to exceed \$350.0 million for the purpose of paying amounts due under the TECP program. The TECP outstanding is also secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of Senior Lien and Junior Lien Obligations. After an issuance of \$200.0 million in TECP, the balance outstanding was \$350.0 million at January 31, 2007.

As of January 31, 2007, and January 31, 2006, CPS Energy was in compliance with the terms and provisions of the documents related to the New Series Bonds, the VRDOs and the TECP.

Debt Service Coverage

CPS Energy's debt service coverage ratio for the New Series Bonds, in accordance with the ordinances, was 2.64x for FY 2007 and 2.72x for FY 2006. The ratio of fund net assets to total debt and fund net assets was 45.8% at January 31, 2007, as compared to 47.5% at January 31, 2006. Both of these ratios exclude the Employee Benefit Plans.

The weighted-average interest rate on outstanding commercial paper was 3.1% at January 31, 2006, and rose to 3.6% at January 31, 2007. The weighted-average maturity of commercial paper at January 31, 2007, and January 31, 2006, was 90 and 96 days, respectively.

Summary of CPS Energy's Bond and Commercial Paper Ratings

	Ratings at January 31, 2007		
	Senior Lien Debt	Junior Lien Debt	TECP
Fitch Ratings	AA+	AA+ / F1+	F1+
Moody's Investors Service, Inc.	Aa1	Aa2 / VMIG 1	P-1
Standard & Poor's Ratings Services	AA	AA- / A-1+	A-1+

OPERATIONAL CHANGES

In 1997, a Joint Operations Agreement ("JOA") between a predecessor of Texas Genco and CPS Energy was arranged to leverage the most efficient generating plants and favorable fuel prices of each utility—other than those related to STP. Under the agreement, Texas Genco scheduled each utility's resources with ERCOT. Due to changes in market conditions and the ERCOT market structure, Texas Genco terminated the agreement as of January 24, 2006.

Effective January 25, 2006, functioning as a Qualified Scheduling Entity ("QSE"), CPS Energy began directly representing its generation and load in the Texas energy marketplace. CPS Energy completed the necessary representations to ERCOT, incorporating business processes and implementing computer systems to support its expanded role. The systems implemented include load forecasting, plant commitment, ERCOT dispatch communications, generation control, wholesale transaction management, scheduling and ERCOT settlement.

Under the JOA, CPS Energy's share of the operational savings, including ERCOT settlements, was recorded to contributed capital. Due to CPS Energy's new QSE status, where it actively markets and schedules its own additional available resources, ERCOT settlements have been recorded to operations.

OTHER CURRENTLY KNOWN FACTS

On June 28, 2006, NRG Energy, Inc. announced plans to construct two additional reactors at the currently functioning two-unit STP site. With this addition, energy production is projected to increase by 2,700 megawatts. NRG Energy, Inc. filed a letter of intent with the Nuclear Regulatory Commission on June 19, 2006, and will proceed with the permitting and development of the new units. CPS Energy, as a current co-owner of the existing site, has an option to participate in this new construction project and is currently conducting its own feasibility study to help determine which course of action is in the best long-term interest of its customers.

In September 2006, the CPS Energy Board of Trustees authorized the sale of the lignite properties in Lee and Bastrop counties. On April 13, 2007, CPS Energy signed a Purchase and Sale Contract with a third party for the sale of the lignite properties.

In December 2006, CPS Energy's Board of Trustees authorized participation in a proposed joint venture with Austin Energy to build a power-generating complex. The complex could begin operating by 2017 and would eventually produce 3,000 megawatts of electricity.

On February 8, 2007, CPS Energy issued \$128.9 million of tax-exempt New Series 2006B Revenue Refunding Bonds. The true interest cost on these bonds was 4.0%. On February 9, 2007, the bond proceeds were used to refund \$77.1 million par value of the taxable New Series 1998B Bonds and \$41.7 million par value of the taxable New Series 2000B Bonds. At that time, CPS Energy cash defeased \$6.5 million par value of the taxable New Series 1998B Bonds that could not be advance refunded with tax-exempt debt. The refunding transaction resulted in net present value debt service savings of \$6.7 million, or 5.3% of the par amount of the bonds refunded.

REQUESTS FOR INFORMATION

For more information about CPS Energy, contact Robert G. McCullough, Director of Corporate Communications, at 210-353-2344 or at P.O. Box 1771, San Antonio, Texas 78296-1771.



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Independent Auditors' Report

The Board of Trustees
City Public Service of San Antonio, Texas:

We have audited the accompanying balance sheets of City Public Service of San Antonio, Texas (CPS Energy), a component unit of the City of San Antonio, Texas, as of January 31, 2007 and 2006, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of CPS Energy's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of City Public Service Employees' Pension Plan in 2007 or 2006 or the financial statements of the City Public Service Disability Income, Group Life Insurance and Group Health Plans (Employee Health and Welfare Plans) in 2007 or 2006. The financial information related to the City Public Service Employees' Pension Plan is included in footnote 8 of the notes to the financial statements. As of January 31, 2007 and 2006, the total assets and net assets of the Employee Health and Welfare Plans represent 2% and 3%, respectively, of the total assets and 7% and 6%, respectively, of the total fund net assets of CPS Energy. Those financial statements were audited by other auditors, for the years indicated, whose reports thereon have been furnished to us, and our opinion on the CPS Energy financial statements, insofar as it relates to the amounts and disclosures included for the City Public Service Employees' Pension Plan and the City Public Service Employee Health and Welfare Plans is based solely on the reports of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of CPS Energy as of January 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 8 through 23 and the schedule of funding progress in footnote 8 of the notes to the financial statements are not a required part of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We, and the other auditors, have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we, and the other auditors, did not audit the information and express no opinion on it.

KPMG LLP Robert Williams CPA Araya, Ruiz & Co., LLC

April 17, 2007

BALANCE SHEETS

	January 31,	
	2007	2006
	(In thousands)	
Assets		
Current assets		
Cash and cash equivalents	\$ 41,344	\$ 96,548
Cash collateral from securities lending	626,370	—
Investments	270,009	145,993
Interest and other receivables	22,513	36,091
Customer accounts receivable, less allowance for doubtful accounts of \$9.7 million at January 31, 2007, and \$8.5 million at January 31, 2006 <i>(includes unbilled revenue of \$37.6 million for January 2007 and \$15.2 million for January 2006)</i>	151,279	117,071
Inventories, at average costs		
Materials and supplies	89,758	87,045
Fossil fuels	43,252	62,500
Prepayments, deferred and other	50,050	55,057
Total current assets	1,294,575	600,305
Noncurrent assets		
Restricted		
Cash and cash equivalents	220,815	53,830
Investments	1,312,496	1,204,539
Interest receivable	7,691	7,187
Prepaid rent – leaseback	476,603	496,392
Other deferred costs	37,414	28,016
Capital assets, net	5,294,792	4,942,636
Total noncurrent assets	7,349,811	6,732,600
Total assets	\$ 8,644,386	\$ 7,332,905
Liabilities		
Current liabilities		
Current maturities of revenue bonds	\$ 141,755	\$ 135,155
Accounts payable and accrued liabilities	314,696	256,176
Securities lending obligation	626,370	—
Total current liabilities	1,082,821	391,331
Noncurrent liabilities		
Long-term debt, net	3,327,551	2,963,596
Decommissioning	448,157	301,072
Deferred lease revenue	543,333	565,893
Other noncurrent liabilities & deferred credits	94,343	94,111
Customer deposits	24,785	22,363
Total noncurrent liabilities	4,438,169	3,947,035
Total liabilities	5,520,990	4,338,366
Fund net assets		
Invested in capital assets, net of related debt	2,118,261	1,949,167
Restricted		
Debt service	5,984	3,582
Ordinance	583,809	666,010
Employee benefit plans	203,127	177,980
Unrestricted	212,215	197,800
Total fund net assets	3,123,396	2,994,539
Total liabilities and fund net assets	\$ 8,644,386	\$ 7,332,905

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	Fiscal Year Ended January 31,	
	<u>2007</u>	<u>2006</u>
	(In thousands)	
Operating revenues		
Electric	\$ 1,515,746	\$ 1,437,798
Gas	254,340	244,921
Total operating revenues	<u>1,770,086</u>	<u>1,682,719</u>
Operating expenses		
Fuel, purchased power and distribution gas	659,839	638,636
STP operation and maintenance	115,269	101,735
Other operation and maintenance	260,569	242,963
Employee benefit plans	25,513	27,820
Regulatory assessments	28,645	37,083
Decommissioning	32,721	10,207
Depreciation and depletion	262,375	246,410
Total operating expenses	<u>1,384,931</u>	<u>1,304,854</u>
Operating income	<u>385,155</u>	<u>377,865</u>
Nonoperating income (expense)		
Interest and other income, net	74,980	48,906
Decommissioning trusts investment income and change in fair market value	28,341	5,827
Employee benefit plans investment income and change in fair market value	18,373	2,486
Interest expense	(161,268)	(149,370)
Amortization of debt reacquisition, issuance, discount and other costs	(4,811)	(8,872)
Allowance for funds used during construction	16,460	4,669
Costs for cash defeasance of debt	(7,243)	-
Payments to the City of San Antonio	(235,898)	(227,178)
Total nonoperating income (expense)	<u>(271,066)</u>	<u>(323,532)</u>
Income before other changes in fund net assets	114,089	54,333
Other transfers to the City of San Antonio	(9,594)	(8,639)
Contributed capital	22,857	63,421
Adjustment for STP pension cost	1,505	(177)
Change in fund net assets	<u>128,857</u>	<u>108,938</u>
Fund net assets – beginning	2,994,539	2,885,601
Fund net assets – ending	<u>\$ 3,123,396</u>	<u>\$ 2,994,539</u>

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF CASH FLOWS

	Fiscal Year Ended January 31,	
	2007	2006
	(In thousands)	
Cash flows from operating activities		
Cash received from customers	\$ 1,750,796	\$ 1,695,703
Cash payments to suppliers for goods and services	(821,612)	(827,805)
Cash payments to employees for service	(164,648)	(163,997)
Net cash provided (used) by operating activities	764,536	703,901
Cash flows from capital and related financing activities		
Cash paid for additions to utility plant and net removal costs	(587,565)	(514,302)
Cash paid for nuclear fuel purchases	(36,174)	(45,636)
Contributed capital	22,857	63,421
Proceeds from issuance of revenue bonds	384,185	222,590
Proceeds from issuance of commercial paper	200,000	-
Premium received from revenue bonds issued	18,452	34,437
Principal payments on revenue bonds and cash defeasance of debt	(241,215)	(130,255)
Interest paid	(159,477)	(148,961)
Debt issue and cash defeasance costs paid	(3,907)	(7,171)
Net cash provided (used) by capital and related financing activities	(402,844)	(525,877)
Cash flows from noncapital financing activities		
Cash payments to the City of San Antonio	(241,439)	(227,126)
Net cash provided (used) by noncapital financing activities	(241,439)	(227,126)
Cash flows from investing activities		
Purchases of investments	(1,417,454)	(1,117,219)
Proceeds from sales and maturities of investments	1,277,421	1,093,819
Net cash increase (decrease) in decommissioning trusts assets	(25,709)	13,189
Net cash increase (decrease) in employee benefit plans assets	(1,959)	(5,075)
Interest and other income	49,206	43,553
Net cash provided (used) by investing activities	(118,495)	28,267
Net increase (decrease) in cash and cash equivalents	1,758	(20,835)
Cash and cash equivalents at beginning of period	150,378	171,213
Cash and cash equivalents at end of period	\$ 152,136	\$ 150,378
<u>Reconciliation of operating income to net cash provided by operating activities</u>		
Cash flows from operating activities		
Operating income	\$ 385,155	\$ 377,865
Noncash items included		
Depreciation and depletion expenses	262,375	246,410
Nuclear fuel amortization	25,668	21,555
Provision for doubtful accounts	7,687	6,083
Changes in current assets and liabilities		
(Increase) decrease in customer accounts receivable, net	(41,895)	13,682
(Increase) decrease in other receivables	12,496	(9,725)
(Increase) decrease in materials and supplies	(2,713)	(14,579)
(Increase) decrease in fossil fuels	19,248	(19,694)
(Increase) decrease in prepayments, deferred and other	5,007	(24,106)
Increase (decrease) in accounts payable and accrued liabilities	55,663	63,337
Changes in noncurrent and other assets and liabilities		
(Increase) decrease in other noncurrent assets and deferred costs	(6,238)	2,573
Increase (decrease) in customer service deposits payable	2,422	2,944
Increase (decrease) in decommissioning trusts liability	40,524	10,191
Increase (decrease) in employee benefit plans liability	(1,095)	(525)
Increase (decrease) in noncurrent liabilities and deferred credits	232	27,890
Net cash provided (used) by operating activities	\$ 764,536	\$ 703,901

See accompanying Notes to Basic Financial Statements.

NOTES TO BASIC FINANCIAL STATEMENTS

January 31, 2007, and January 31, 2006

1. Summary of Significant Accounting Policies

Reporting Entity – City Public Service of San Antonio (also referred to as “CPS Energy,” “CPS” or the “Company”) is a municipal utility owned by the City of San Antonio, Texas (“City”) since 1942. It provides electricity and natural gas to San Antonio and surrounding areas. As a municipal utility, CPS Energy is exempt from the payment of income taxes, state franchise taxes, sales taxes, and real and personal property taxes. CPS Energy provides certain payments and benefits to the City as permitted by bond ordinances. CPS Energy’s financial results are also included within the comprehensive annual financial report of the City.

The decision to include applicable component units in CPS Energy’s financial statements was made by applying the criteria set forth in the Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*. Accordingly, the reporting entity reflected in these financial statements consists of CPS Energy’s financials and certain component units, which are legally separate, but for which CPS Energy is financially accountable.

The relationships among the component units and CPS Energy meet the criteria as set forth in GASB Statement No. 14. Accordingly, the financial statements of the following components are blended with those of CPS Energy:

- Decommissioning Trusts – The City Public Service Restated Decommissioning Master Trust for the South Texas Project (“28% Decommissioning Trust”) and the City Public Service Decommissioning Master Trust (TCC Funded) (“12% Decommissioning Trust”), herein collectively referred to as the Decommissioning Trusts.
- Employee Benefit Plans – The City Public Service of San Antonio Disability Income, the Group Life Insurance and the Group Health Plans, herein collectively referred to as the Employee Benefit Plans.

Within these financial statements are the applicable financial results for 40% of the South Texas Project (“STP”).

The financial statements of CPS Energy’s Pension Plan are separately audited and reported. According to the GASB Staff Implementation Guide for GASB Statement No. 14, if an entity is acting in a trustee capacity in regard to its pension plan, the assets of the pension plan should not be evaluated as a potential component unit, but should be reported separately. CPS Energy, through its Oversight Committee and Administrative Committee, acts in a trustee capacity for the Pension Plan. Therefore, consistent with the GASB Statement No. 14 Implementation Guide, the Pension Plan has not been categorized as a component unit of CPS Energy. The financial results are not included herein except for certain disclosures as provided in Note 8 – Employee Pension Plan.

Fiscal Year – Notwithstanding interim measurement dates where referenced specifically, the fiscal year ended January 31, 2007, is referred to herein as FY 2007. The fiscal years ended January 31, 2006, and January 31, 2005, are referred to herein as FY 2006 and FY 2005, respectively.

Basis of Accounting – The financial statements of CPS Energy are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) for proprietary funds of governmental entities. CPS Energy, including the Employee Benefit Plans and Decommissioning Trusts, complies with all applicable pronouncements of GASB. In accordance with GASB Statement No. 20, *Accounting and*

Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, CPS Energy has elected not to follow the pronouncements of the Financial Accounting Standards Board ("FASB") issued after November 30, 1989.

STP is a nonprofit special-purpose entity that reports under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to STP's financial information within CPS Energy's financial statements for these differences.

CPS Energy FY 2007 Pronouncement Implementations:

- GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The statement establishes uniform standards of financial reporting for other postemployment benefit ("OPEB") plans. The statement establishes disclosure requirements for both the Employee Benefit Plans and employer financial statements. Disclosure requirements for the employer have been incorporated into Note 9 – Employee and Other Postemployment Benefits.
- GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Provisions of Medicare Part D*. The technical bulletin clarifies the application of existing standards of accounting and financial reporting to payments received by an employer or directly by OPEB Plans from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. Those disclosures applicable to the employer, which are required with the implementation of GASB Statement No. 43, have been incorporated into Note 9 – Employee and Other Postemployment Benefits.

CPS Energy FY 2006 Pronouncement Implementations:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The statement provides guidance for determining if any assets have been impaired and for calculating the appropriate write-downs in value for any assets found to be impaired. The statement also provides guidance for accounting for any insurance proceeds received for impaired capital assets. For additional information, see Note 4 – Capital Assets, Net.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*. The statement requires governments to disclose the portion of total net assets restricted by enabling legislation. CPS Energy currently discloses restricted funds designated by law, ordinance or contract. As of January 31, 2007, and January 31, 2006, CPS Energy had no fund net assets restricted by enabling legislation.
- GASB Statement No. 47, *Accounting for Termination Benefits*. The statement requires that an employer recognize a liability and expense for voluntary and involuntary termination benefits. As of January 31, 2007, and January 31, 2006, CPS Energy had no termination benefits in place.

In accordance with the utility systems revenue bond ordinances, CPS Energy has adopted the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners. The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

Reclassifications – Certain amounts in the prior year's financial statements have been reclassified to conform to the current year presentation.

Revenues and Expenses – Revenues are recorded when earned. Customers' meters are read and bills are prepared monthly based on billing cycles. Rate schedules include adjustment clauses that permit recovery of electric fuel and gas costs. Since fiscal year ended January 31, 2004, CPS Energy has used historical information from the relative prior fiscal years as partial bases to estimate and record earned revenue not yet billed. This process has involved an extrapolation of customer usage over the days since the last meter read through the last day of the monthly period. The amounts of unbilled revenue receivable recorded at January 31, 2007, and January 31, 2006, including estimates for electric fuel and gas costs, were \$37.6 million and \$15.2 million, respectively.

CPS Energy's electric fuel cost adjustment clause also permits recovery of regulatory assessments. Specifically beginning in March 2000, CPS Energy began recovering assessments from the Public Utility Commission of Texas ("PUCT") for transmission access charges and from the Texas Independent System Operator, also known as the Electric Reliability Council of Texas ("ERCOT"), for its operating costs and other charges applicable to CPS Energy as a wholesale provider of power to other utilities. Regulatory assessments for FY 2007 and FY 2006 were \$28.6 million and \$37.1 million, respectively.

Operating revenues include receipts from energy sales and miscellaneous revenue related to the operation of electric and gas systems. Miscellaneous revenue includes late payment fees, rental income, jobbing and contract work, and ancillary services. Operating expenses are recorded as incurred and include those costs that result from the ongoing operations of the electric and gas systems.

Nonoperating revenue consists primarily of investment income, including fair market value adjustments. The amortization of net gains from the lease/leaseback of J.K. Spruce Unit 1 ("Spruce 1") and the sale of water rights, when applicable, are also included. Certain miscellaneous income amounts from renting general property and providing various services are also recorded as nonoperating when they are not directly identified with the electric or gas systems. These amounts for FY 2007 and FY 2006 were recorded net of expenses.

Capital Assets – The costs of additions and replacements of assets identified as major components or property units are capitalized. Maintenance and replacements of minor items are charged to operating expenses. Except for certain assets that may become impaired, the cost of depreciable plant retired, plus removal costs and less salvage, is charged to accumulated depreciation. Per the financial reporting requirements of GASB Statement No. 42, any losses associated with capital asset impairments will be charged to operations, not to accumulated depreciation.

Utility plant is stated at the cost of construction, including expenditures for contracted services; direct equipment, material and labor; indirect costs, including general engineering, labor, equipment and material overheads; and an allowance for funds used during construction ("AFUDC"), which represents capitalized interest. CPS Energy computes AFUDC using rates that approximate the cost of borrowed funds measured as the short-term investment rate for other funds used for construction. Noncash AFUDC is applied to projects estimated to require 30 days or more to complete.

Proceeds from customers and certain litigation settlements to partially fund construction expenditures are reported in the Statements of Revenues, Expenses and Changes in Fund Net Assets as increases in fund net assets in accordance with the requirements of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

Except for nuclear fuel, which is amortized over units of production, CPS Energy computes depreciation using the straight-line method over the estimated service lives of the depreciable property according to asset type. Total depreciation as a percent of total depreciable assets, excluding nuclear fuel, was 3.3% for both FY 2007 and FY 2006.

The estimated useful lives of capital assets for both FY 2007 and FY 2006 were as follows:

Buildings and structures	15-60 years
Systems and improvements	
Generation	8-45 years
Transmission and distribution	20-55 years
Gas	50-65 years
Machinery and equipment	4-30 years
Lignite mineral rights and other	20-40 years
Nuclear fuel	Units of Production

Cash Equivalents and Investments, Unrestricted and Restricted – CPS Energy's investments with a maturity date within one year of the purchase date are reported at amortized cost, which approximates fair value. Amortization of premium and accretion of discount are recorded over the terms of the investments that mature within one year. CPS Energy's investments with a maturity date of one year or longer from the purchase date are accounted for using fair value. Fair value is determined by using generally accepted financial reporting services, publications, dealers and brokers as necessary. The specific identification method is used to determine cost in computing gain or loss on sales of securities. CPS Energy reports all investments of the Decommissioning Trusts and the Employee Benefit Plans at fair market value.

Restricted funds are generally for uses other than current operations. They are designated by law, ordinance or contract and are often used to acquire or construct noncurrent assets. Restricted funds consist primarily of unspent bond or commercial paper proceeds, debt service required for the New Series Bonds and Junior Lien Obligations, and funds for future construction or contingencies. This category also includes customer assistance programs where proceeds are received from outside parties. The assets of the Decommissioning Trusts and the Employee Benefit Plans are also considered restricted.

The Repair and Replacement Account is restricted in accordance with the Company's bond ordinances. In compliance with an ordinance, CPS Energy's Board of Trustees authorized that a portion of the Repair and Replacement Account be designated for converting overhead electric facilities to underground (also referred to as Overhead Conversion Fund).

In January 2005, CPS Energy's Board of Trustees approved a policy to expand the use of the Overhead Conversion Fund. Beginning in FY 2006, the annual 1.0% funding was redesignated for Community Infrastructure and Economic Development ("CIED") projects. Additionally, the basis of the funding was modified to be 1.0% of the prior fiscal year's Electric Base Rate Revenue, which excludes certain items such as applicable fuel adjustments and regulatory fees. In general, the restricted CIED funds are to be used to support qualified capital projects that provide economic benefit within the communities served. At January 31, 2007, and January 31, 2006, all such appropriated funds were included with the assets restricted by bond ordinance.

As initiated in FY 2006, in lieu of CIED funding, the City may alternatively request an equivalent amount of general funds to be transferred for its use. In such cases, the amount previously designated for CIED funding is returned to the Repair and Replacement Account and general funds are transferred to the City. In accordance with bond ordinances, the combined total of direct distributions and City payments is limited to 14% of gross revenues.

In FY 2007, CPS Energy and the Decommissioning Trusts entered into agreements with Frost National Bank, a Texas-based financial institution, for the purpose of securities lending. The cash collateral received for loaned securities is reported as an asset on the Balance Sheet. The obligation for the cash collateral is reported on the Balance Sheet as a liability that directly offsets the amount received from

brokers or dealers in exchange for securities loaned. See Note 11 – Other Financial Instruments for details regarding securities lending.

See Note 2 – Cash, Cash Equivalents and Investments for additional disclosures that have been provided in accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. These disclosures address investment exposure to interest rate, concentration of credit, credit and foreign currency risks, as applicable.

Other Noncurrent Assets and Deferred Costs – In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon Corporation (“Exelon”), formerly known as Unicom Corporation. The long-term portion of prepaid rent related to this transaction was recorded as a deferred cost in the fiscal year ended January 31, 2001. In addition, \$12.3 million was paid to the City, in accordance with the New Series Bond Ordinances, for its 14% share of the net benefit from the transaction. This was recorded as a prepaid item and is being amortized over the life of the lease.

Noncurrent assets include unamortized debt-issuance expenses, which are amortized over the life of the bonds. Other assets include the long-term receivable from the San Antonio Water System for the sale of water rights in fiscal year 2000, as well as the restricted cash collateral from securities lending.

Long-Term Debt – To support its long-term capital financing needs, CPS Energy uses several types of debt instruments. As of January 31, 2007, and January 31, 2006, these included fixed-rate and variable-rate bonds, and commercial paper. Relative to the bond instruments, provisions may be included that allow for refunding after specified time periods during the bond term.

Current refundings involve issuing new debt (“refunding bonds”) to redeem existing debt (“refunded bonds”) that can be called within 90 days of issuing the refunding bonds. Advance refunding bonds involve issuing new debt to redeem existing debt that cannot be called within 90 days of issuing the refunding bonds. In these circumstances, the refunding bond proceeds are escrowed with a third party. These proceeds, and income thereon, are used to pay the debt service on the refunded bonds until the refunded bonds can be called. Deposit of the refunding bond proceeds with such a third party results in a legal defeasance of the refunded bonds, and these refunded bonds do not appear on the Balance Sheets. Refunding bonds are generally issued to achieve debt service savings.

For current and advance refundings, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a deduction or addition to the new debt liability. The deferred amount is amortized as a component of interest expense over the shorter remaining life of the refunding or the refunded debt.

Subject to applicable timing restrictions that may prevent early payoff, CPS Energy also has the option to defease or extinguish debt with cash. A bond defeasance occurs when cash is placed in an irrevocable trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, which fully discharges the bond issuer’s obligation.

At the time of an extinguishment with cash, since the issuer no longer has the legal obligation, the defeased debt is removed from the balance sheet, the related unamortized costs are expensed and the gain or loss is immediately recognized.

Other Noncurrent Liabilities and Deferred Credits – The long-term portion of the deferred revenue associated with the lease/leaseback was recorded as a deferred credit and is being amortized over the life of the lease.

Other liabilities and deferred credits include the obligations of the Decommissioning Trusts, customer service deposits, advance payments from customers for construction, the restricted cash collateral from

securities lending and the Department of Energy special assessments. The long-term portion of the payable to the Greater Kelly Development Authority ("GKDA") for the purchase of electric and gas properties in fiscal year ended January 31, 2000 has also been recorded in other liabilities. In FY 2006, GKDA changed its name to Port Authority of San Antonio.

Compensated Absences – Employees earn vacation benefits based upon their employment status and years of service. As of January 31, 2007, and January 31, 2006, the accruals for those vested benefits were \$13.8 million and \$12.7 million, respectively.

Inventories – CPS Energy maintains inventories for its materials and supplies and fossil fuels. In total, CPS Energy reported ending inventories of \$133.0 million and \$149.5 million at January 31, 2007, and January 31, 2006, respectively. Included in these amounts were CPS Energy's portion of STP inventories valued at \$41.2 million and \$38.4 million at the end of FY 2007 and FY 2006, respectively. STP values its inventories at the lower of average cost or net realizable value. CPS Energy's remaining directly managed inventories are valued using an average costing approach.

Statements of Cash Flows – For purposes of reporting cash flows, CPS Energy considers all highly liquid debt instruments purchased with an original maturity of 90 days or less to be cash equivalents. Noncash transactions have been excluded from CPS Energy's Statements of Cash Flows.

FY 2007 – The following is a summary of noncash investing, capital and related financing activities for FY 2007:

- In August 2006, a noncash accounting loss of \$6.1 million, representing unamortized bond issue, reacquisition and premium/discount costs, was recorded to nonoperating expense in connection with the cash defeasance of the New Series 1997 Revenue and Refunding Bonds.
- Securities lending cash collateral of \$626.4 million for CPS Energy and \$110.0 million for the Decommissioning Trusts was recorded as an asset with a corresponding liability for the obligation to repay the collateral.

FY 2006 – The following is a summary of noncash investing, capital and related financing activities for FY 2006:

- In April 2005, \$310.0 million in proceeds from the issuance of refunding bonds was directly deposited to an escrow account established for the exclusive purpose of refunding \$295.7 million in revenue bonds.
- In October 2005, \$200.0 million in proceeds from the issuance of refunding bonds was directly deposited to an escrow account established for the exclusive purpose of redeeming \$200.0 million in outstanding commercial paper.
- As part of the additional 12% acquisition of STP, CPS Energy assumed the 12% Decommissioning Trust assets of \$66.3 million from AEP Texas Central Company ("AEP"). A decommissioning trust liability in the same amount was also assumed.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the amounts of revenues and expenses reported during the fiscal periods. Accordingly, actual results could differ from those estimates.

2. Cash, Cash Equivalents and Investments

Investment Options – CPS Energy's cash deposits at January 31, 2007, and January 31, 2006, were entirely insured by federal depository insurance or collateralized by banks. For deposits that were collateralized, the securities were U.S. Government, U.S. Government Agency or U.S. Government-guaranteed obligations held in book entry form by Frost National Bank in CPS Energy's name.

Cash and Cash Equivalents

	January 31,	
	2007	2006
	(In thousands)	
Cash and cash equivalents		
Petty cash funds on hand	\$ 102	\$ 138
Bond paying agent – debt service – restricted	742	639
Deposits with financial institutions		
Unrestricted CPS deposits	68	10,011
Restricted CPS deposits		
Capital projects	14	1
Debt service	1,420	–
Project Warm	383	111
Employee benefit plans	51	608
Investments with original maturities of less than 90 days		
CPS unrestricted (current)	667,544	86,399
CPS restricted (noncurrent)	76,296	11,384
Decommissioning trusts – restricted (noncurrent)	120,283	23,739
Employee benefit plans – restricted (noncurrent)	21,626	17,348
Total cash and cash equivalents	<u>\$ 888,529</u>	<u>\$ 150,378</u>

Separation – CPS Energy's cash, cash equivalents and investments can be separated in the following manner:

- Those directly managed by CPS Energy,
- Those managed through the Decommissioning Trusts, and
- Those managed through the Employee Benefit Plans.

For financial reporting purposes, cash, cash equivalents and investments managed directly by CPS Energy have been consistently measured as of the end of the applicable fiscal years. The Decommissioning Trusts and the Employee Benefit Plans are reported on a calendar-year basis.

**Summary of Cash and Cash Equivalents,
Along with Current and Noncurrent Investments**

	January 31,	
	2007	2006
	(In thousands)	
Cash and cash equivalents		
CPS unrestricted and restricted	\$ 746,570	\$ 108,683
Decommissioning trusts – restricted	120,283	23,739
Employee benefit plans – restricted	21,676	17,956
Total cash and cash equivalents	<u>888,529</u>	<u>150,378</u>
Gross investments – current and noncurrent		
CPS unrestricted and restricted	1,815,166	1,007,602
Decommissioning trusts – restricted	447,104	300,343
Employee benefit plans – restricted	205,984	181,457
Total gross investments	<u>2,468,254</u>	<u>1,489,402</u>
Investments with original maturities of less than 90 days also included in cash equivalents		
CPS unrestricted and restricted	(743,840)	(97,783)
Decommissioning trusts – restricted	(120,283)	(23,739)
Employee benefit plans – restricted	(21,626)	(17,348)
Total	<u>(885,749)</u>	<u>(138,870)</u>
Net current and noncurrent investments	<u>1,582,505</u>	<u>1,350,532</u>
Total cash, cash equivalents and investments	<u>\$ 2,471,034</u>	<u>\$ 1,500,910</u>

Public Funds Investment Act (“PFIA”) – CPS Energy’s direct investments and the investments held in the Decommissioning Trusts are subject to the rules and regulations of the PFIA. The PFIA regulates what types of investments can be made, requires written investment policies, mandates training requirements of investment officers, requires internal management reports to be produced at least quarterly, and provides for the selection of authorized brokers. In September 2005, the PFIA was amended to allow the decommissioning trust funds for municipally owned nuclear power plants to hold investments authorized by Subtitle B, Title 9, of the Property Code (i.e., corporate bonds and equities such as common stocks).

Direct Investments of CPS Energy – CPS Energy’s allowable direct investments are defined by CPS Energy Board Resolution, CPS Energy Investment Policy, Bond Ordinances, Tax-Exempt Commercial Paper (“TECP”) Ordinance and state law. These investments are subject to market risk, and their market value will vary as interest rates fluctuate. All CPS Energy direct investments are held in trust custodial funds by an independent bank.

Investments of the Decommissioning Trusts – CPS Energy’s investments in the Decommissioning Trusts are held by an independent trustee. Investments are limited to those defined by CPS Energy Board Resolution, the South Texas Project Decommissioning Trust Investment Policy, the Investment Strategy Committee, the Trust Agreements and state law. Allowable investments for the Decommissioning Trusts include those mentioned above as directly permissible for CPS Energy, as well as equities and corporate bonds. Specifically, starting in September 2005, in accordance with the applicable amended investment policies, equity investments held can comprise 60.0% of total investments.

Investments of the Employee Benefit Plans – Investments in the Employee Benefit Plans are also held by an independent trustee. With the exception of real estates, these investments are limited to the same types mentioned above as authorized by the plans’ Administrative Committees, the Trust

Agreements and state law. Equity investments can comprise 60.0% of total investments in the health plan and can comprise 65.0% of total investments in the disability and life plans.

Permissible Investments

Investment Description	CPS Energy Direct Investments	Decommissioning Trusts	Employee Benefit Plans
U.S. government, government agency, or U.S. government-guaranteed obligations	•	•	•
Collateralized mortgage obligations issued by the U.S.	•	•	•
Fully secured certificates of deposit issued by a state, national or savings bank domiciled in the state of Texas	•	•	•
Direct repurchase agreements	•	•	•
Reverse repurchase agreements	•	•	•
Defined bankers acceptances and commercial paper	•	•	•
No-load money market mutual funds	•	•	•
Other specific types of secured or guaranteed investments	•	•	•
Equities	N/A	•	•
Corporate bonds	N/A	•	•
International securities	N/A	•	•
Securities lending	•	•	•
Real Estate	N/A	N/A	•

Cash, Cash Equivalents and Investments by Fund

	January 31,	
	2007	2006
	(In thousands)	
Unrestricted		
Cash and cash equivalents	\$ 667,714	\$ 96,548
Investments	270,009	145,993
Total unrestricted (current)	<u>937,723</u>	<u>242,541</u>
Restricted		
Debt service		
Cash and cash equivalents	5,963	685
Investments	-	2,895
Total debt service	<u>5,963</u>	<u>3,580</u>
Capital projects		
Cash and cash equivalents	14	1
Investments	285,042	103,174
Total capital projects	<u>285,056</u>	<u>103,175</u>
Ordinance		
Cash and cash equivalents	72,496	11,338
Investments	508,972	650,525
Total ordinance	<u>581,468</u>	<u>661,863</u>
Project Warm		
Cash and cash equivalents	383	111
Investments	7,302	7,232
Total Project Warm	<u>7,685</u>	<u>7,343</u>
Decommissioning trusts		
Cash and cash equivalents	120,283	23,739
Investments	326,821	276,604
Total decommissioning trusts	<u>447,104</u>	<u>300,343</u>
Employee benefit plans		
Cash and cash equivalents	21,676	17,956
Investments	184,359	164,109
Total employee benefit plans	<u>206,035</u>	<u>182,065</u>
Total restricted		
Cash and cash equivalents	220,815	53,830
Investments	1,312,496	1,204,539
Total restricted (noncurrent)	<u>1,533,311</u>	<u>1,258,369</u>
Total cash, cash equivalents and investments – unrestricted and restricted	<u>\$ 2,471,034</u>	<u>\$ 1,500,910</u>

Risk Exposure – Cash equivalents and fixed-income investments are exposed to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk. Interest rate risk is the exposure to fair market value losses resulting from rising interest rates. Credit risk is the risk that an issuer of an investment will not fulfill its obligations (will be unable to make timely principal and interest payments on the security). Foreign currency risk is the exposure to fair market value losses arising from changes in exchange rates. Cash, cash equivalents and fixed-income investments are also exposed to inflation, liquidity, political, legal, event, reinvestment and timing (call) risk. Additionally, equity investments are exposed to political, legal, event and general economic risk.

CPS Energy identifies and manages all of these risks by following an appropriate investment oversight strategy, establishing and monitoring compliance with investment policies and procedures, and continually monitoring prudent controls over risks. All investment policies follow the “prudent person” concept.

Summary of Investments by Organizational Structure and Type

	January 31,	
	2007	2006
	(In thousands)	
CPS investments		
U.S. Treasury, Government Agencies and money market funds*	\$ 1,815,166	\$ 1,007,602
Decommissioning trusts		
U.S. Treasury, Government Agencies and money market funds	224,912	143,095
Corporate bonds	42,920	20,149
Foreign bonds	1,576	843
Subtotal*	269,408	164,087
Common stock	177,696	136,256
Total decommissioning trusts	447,104	300,343
Employee benefit plans		
Money market mutual funds	21,626	17,348
Corporate bonds	19,504	26,989
Foreign bonds	8,876	8,282
U.S. Treasury and Government Agencies securities	29,047	18,208
Subtotal*	79,053	70,827
Common stock	111,457	100,894
International equities	6,956	1,300
Real estate	8,518	8,436
Total employee benefit plans	205,984	181,457
Grand total – all investments	\$ 2,468,254	\$ 1,489,402

*These items are subject to GASB Statement No. 40 evaluation, as provided below.

Investment Policies and the Adoption of GASB Statement No. 40 – Effective September 1, 2005, the investment policies of the Decommissioning Trusts were revised to allow for investment in additional types of securities, such as corporate bonds and equity securities. The policies provide guidelines to ensure all funds are invested in authorized securities in order to earn a reasonable return. The primary emphasis is placed on long-term growth commensurate with the need to preserve the value of the assets and, at the time funds are needed for decommissioning costs, on liquidity. The investment policies continue to follow the “prudent person” concept.

In November 2005, the Oversight Committees of the Employee Benefit Plans formally adopted Statements of Investment Objectives, Policy, Guidelines, and Administrative and Review Procedures. The investment objectives of the plans are to preserve plan assets through investment diversification and the trading of high quality securities and to provide sufficient liquidity to pay plan benefits. These investment policies also follow the “prudent person” concept.

In accordance with GASB Statement No. 40, additional disclosures have been provided in this note that address investment exposure to interest rate, concentration of credit, credit and foreign currency risks, as applicable. The disclosure requirements of this GASB statement do not apply to equity securities or real estate since neither is directly or immediately exposed to these risks. CPS Energy and its component units do not have custodial credit risk, as all investments are held either by an independent trustee or bank and are in CPS Energy's and the component units' names.

CPS Energy Direct Investments

In accordance with GASB Statement No. 40, the following tables address interest rate risk exposure by investment type using the weighted-average maturity ("WAM") method, concentration of credit risk and credit risk. Since CPS Energy does not hold foreign instruments in its direct investments—those not held by a component unit—foreign currency risk is not applicable.

Interest rate risk – In accordance with its investment policy, CPS Energy manages exposure to fair market value losses resulting from rising interest rates by limiting the portfolio's WAM to two years or less. WAM is defined as the weighted-average time to return a dollar of principal. It is used as an estimate of the interest rate risk of a fixed-income investment. CPS Energy invests the cash collateral received from securities lending and other funds in money market mutual funds that have no fixed maturities. Accordingly, a WAM in terms of years for money market mutual funds is not applicable.

Concentration of credit risk – In accordance with its investment policy, CPS Energy manages exposure to concentration of credit risk through diversification and by limiting its investment in each government-sponsored entity to 50.0% and its investment in any nongovernment issuer to 5.0% of the total fixed-income portfolio.

(In thousands)

Investment Type	January 31, 2007				January 31, 2006			
	Carrying Value	Market Value	Allocation	Weighted-Average Maturity (Years)	Carrying Value	Market Value	Allocation	Weighted-Average Maturity (Years)
U.S. Agencies								
Federal Home Loan Mortgage Corp	\$ 593,426	\$ 593,300	32.6%	0.4	\$ 230,231	\$ 230,145	22.8%	0.6
Federal National Mortgage Assn	421,804	421,785	23.1%	0.3	239,097	239,036	23.7%	0.5
Federal Home Loan Bank	131,066	131,037	7.2%	0.7	437,529	437,491	43.5%	0.5
Federal Farm Credit Bank	-	-	-	-	14,876	14,876	1.5%	0.4
Total fixed-income investments	1,146,296	1,146,122	62.9%	0.4	921,733	921,548	91.5%	0.5
Cash collateral - securities lending	626,370	626,370	34.7%	-	-	-	-	-
AIM money market	42,500	42,500	2.4%	-	85,869	85,869	8.5%	-
Total portfolio	\$ 1,815,166	\$ 1,814,992	100.0%	-	\$ 1,007,602	\$ 1,007,417	100.0%	-

Credit risk – In accordance with its investment policy, CPS Energy manages exposure to credit risk by limiting its fixed-income investments to a credit rating of "A" or better. As of January 31, 2007, and January 31, 2006, CPS Energy held no direct investments with a credit rating below "AAA."

(In thousands)

Credit Rating	January 31, 2007			January 31, 2006		
	Carrying Value	Market Value	Allocation	Carrying Value	Market Value	Allocation
AAA	\$ 1,815,166	\$ 1,814,992	100.0%	\$ 1,007,602	\$ 1,007,417	100.0%
Total fixed-income investments	\$ 1,815,166	\$ 1,814,992	100.0%	\$ 1,007,602	\$ 1,007,417	100.0%

Decommissioning Trusts Investments

As mentioned above, the Decommissioning Trusts report their assets on a calendar-year basis; therefore, the tables in this section are as of December 31.

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk. All investments held by the Decommissioning Trusts are long-term in nature and recorded at market value.

Interest rate risk – Generally, the long-term nature of the liabilities, and the limited need for daily operating liquidity, allows interim fluctuations in market value to occur without jeopardizing the ultimate value of the assets. Where long-term securities are held, the interim market value of assets can be sensitive to changes in interest rates. As the general level of interest rates moves up and down, the interim market value of longer-maturity bonds may change substantially. One of the techniques used to mitigate this risk is having a duration limitation. The overall portfolio duration should not deviate from the weighted-average duration of the Investment Strategy Committee's specified fixed-income index by more than +/- 1.5 years. The Investment Strategy Committee's fixed-income index is based on the Lehman Brothers Aggregate Index, which was 4.5 for 2006 and 4.6 for 2005.

Weighted-average duration is defined as the weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows and is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates.

Concentration of credit risk – In accordance with the investment policy, exposure to concentration of credit risk is managed through diversification and by limiting investments in each government-sponsored entity to 30.0% and investments in any nongovernment-sponsored issuer to 5.0% of the total fixed-income portfolio (excluding cash collateral from securities lending). At December 31, 2006, total nongovernment-sponsored (corporate and foreign) issuers amounted to 30.9% of the 28% Decommissioning Trust and 16.0% of the 12% Decommissioning Trust.

The following tables list the fixed-income investment holdings by type:

(In thousands)

Investment Type – 28% Interest	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
U.S. Treasuries	\$ 24,232	12.0%	3.3	\$ 60,584	44.7%	3.5
U.S. Agencies						
Federal National Mortgage Assn	32,727	16.2%	3.8	24,333	17.9%	4.1
Federal Home Loan Mortgage Corp	14,221	7.0%	3.4	10,148	7.5%	4.3
Small Business Admin	4,817	2.4%	3.1	1,880	1.4%	5.1
Federal Home Loan Bank	-	-	-	563	0.4%	1.8
Municipal bonds - Texas	305	0.1%	2.7	-	-	-
Municipal bonds - other states	1,776	0.9%	8.2	-	-	-
Corporate bonds	37,776	18.6%	6.0	14,860	10.9%	8.3
Foreign bonds	1,576	0.8%	11.3	843	0.6%	33.3
Total fixed-income investments	117,430	58.0%	4.5	113,211	83.4%	4.6
Cash collateral - securities lending	75,178	37.1%		-	-	
AIM money market	9,832	4.9%		22,475	16.6%	
Total portfolio	\$ 202,440	100.0%		\$ 135,686	100.0%	

(In thousands)

	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type – 12% Interest						
U.S. Treasuries	\$ 7,024	10.5%	5.4	\$ 5,902	20.8%	2.6
U.S. Agencies						
Federal Home Loan Mortgage Corp	6,132	9.2%	4.3	3,805	13.4%	5.5
Federal National Mortgage Assn	6,136	9.2%	4.0	5,497	19.4%	4.7
Government National Mortgage Assn	2,714	4.0%	4.0	1,348	4.7%	4.2
Municipal bonds – Texas	281	0.4%	7.7	684	2.4%	12.4
Municipal bonds – other states	4,264	6.4%	4.7	4,613	16.2%	5.6
Corporate bonds	5,144	7.7%	4.8	5,289	18.6%	4.3
Total fixed-income investments	31,695	47.4%	4.6	27,138	95.5%	4.5
Cash collateral – securities lending	34,845	52.0%		-	-	
AIM money market	428	0.6%		1,263	4.5%	
Total portfolio	\$ 66,968	100.0%		\$ 28,401	100.0%	

Credit risk— In accordance with the investment policies, exposure to credit risk is managed by limiting all fixed-income investments to a credit rating of “BBB-” or better from at least two nationally recognized credit rating agencies.

(In thousands)

	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – 28% Interest				
U.S. Treasuries	\$ 24,232	12.0%	\$ 60,584	44.7%
AAA	150,862	74.5%	59,931	44.2%
AA	140	0.1%	525	0.4%
A	12,376	6.1%	4,595	3.4%
BBB	14,830	7.3%	9,429	6.9%
Unrated – foreign bonds	-	-	622	0.4%
Total fixed-income investments	\$ 202,440	100.0%	\$ 135,686	100.0%

(In thousands)

	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – 12% Interest				
U.S. Treasuries	\$ 7,024	10.5%	\$ 5,902	20.8%
AAA	55,832	83.4%	18,744	66.0%
AA	1,282	1.9%	822	2.9%
A	2,233	3.3%	2,933	10.3%
BBB	597	0.9%	-	-
Total fixed-income investments	\$ 66,968	100.0%	\$ 28,401	100.0%

Foreign currency risk – With the exception of dedicated foreign-equity portfolios, all investments authorized for purchase by the Decommissioning Trusts are U.S. dollar-denominated. This, along with the low level of foreign fixed-income investment, reduced the potential currency risk exposure to the portfolio. Total foreign bonds outstanding—both rated and unrated—amounted to \$1.6 million as of December 31, 2006, and \$842.6 thousand as of December 31, 2005.

Employee Benefit Plan Investments

The Employee Benefit Plans consist of three separate plans:

- City Public Service of San Antonio Group Health Plan (“health plan”)
- City Public Service of San Antonio Disability Income Plan (“disability plan”)
- City Public Service of San Antonio Group Life Insurance Plan (“life plan”)

As mentioned above for the Decommissioning Trusts, the Employee Benefit Plans report their assets on a calendar-year basis; therefore, the tables in this section are as of December 31.

The Health Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk.

Interest rate risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to fair value losses resulting from rising interest rates by limiting the effective duration of each manager’s portfolio to +/- 1.5 years of the effective duration of the specified fixed-income index used as a benchmark for the investment manager’s portfolio. In addition, the duration of the aggregate fixed-income portfolio of the trust should not deviate from the duration of the specified fixed-income index used as a benchmark for the aggregate portfolio by more than +/- 1.5 years.

Effective duration is defined as the present value weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows. It is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates.

Concentration of credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee has established maximum holdings of other than federal government issuers so that in the event of failure of any one issuer it would not affect the entire investment portfolio. Further, exposure to credit risk is managed through diversification and by limiting the amount that may be invested in any one corporate bond issuer to 5.0% of the market value of an investment manager’s fixed-income portfolio. In addition, the maximum investment in any one corporate bond or note should not exceed 5.0% of the market value of the aggregate fixed-income portfolio. There is no such concentration restriction on the investment in government-guaranteed or government agency debt issues, other than government agency debt may not exceed 50.0% by any one issuer. There were no corporate bonds exceeding these limits at December 31, 2006, or December 31, 2005.

The following table lists the fixed-income investment holdings by type:

(In thousands)	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type - Health						
U.S. Treasuries	\$ 3,094	5.2%	7.7	\$ 4,196	8.0%	8.7
U.S. Agencies						
Federal National Mortgage Assn	6,376	10.7%	3.8	4,955	9.5%	4.0
Federal Home Loan Mortgage Corp	8,168	13.7%	3.4	2,564	4.9%	3.6
Federal Home Loan Bank	962	1.6%	3.9	147	0.3%	3.0
Government National Mortgage Assn	25	-	3.1	32	0.1%	2.7
Corporate bonds	14,925	25.0%	5.1	19,435	37.2%	5.4
Foreign bonds	6,481	10.9%	4.4	6,047	11.6%	4.5
Total fixed-income investments	40,031	67.1%	4.6	37,376	71.6%	5.3
AIM money market	19,654	32.9%		14,845	28.4%	
Total portfolio	\$ 59,685	100.0%		\$ 52,221	100.0%	
Specified fixed-income index:						
Lehman Brothers U.S. Aggregate Index			4.5			4.6
Citigroup High Yield Bond Index			4.5			4.6
Citigroup World Government Bond Index			6.0			5.9

Credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their total portfolio in bonds rated below BBB. The investment policy also authorizes the Administrative Committee to retain investment managers to manage “high yield” debt securities. The maximum allocation to high yield securities is 7.5% of total investments, which equated to 29.0% and 19.2% of total fixed-income investments at December 31, 2006, and December 31, 2005, respectively.

(In thousands)	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating - Health				
U.S. Treasuries	\$ 3,094	5.2%	\$ 4,196	8.0%
AAA	38,317	64.2%	31,180	59.7%
AA	1,610	2.7%	892	1.7%
A	2,318	3.9%	3,526	6.8%
BBB	1,239	2.0%	373	0.7%
Less than BBB	6,626	11.1%	6,007	11.5%
Navarro Investments, L.L.C. - see below	6,481	10.9%	6,047	11.6%
Total fixed-income investments	\$ 59,685	100.0%	\$ 52,221	100.0%

As noted above, even though at the end of calendar years 2006 and 2005, the health plan held approximately 10.9% and 11.6%, respectively, of its fixed-income investments in funds that were not rated by a rating agency, the majority of the underlying securities were rated. The following table reflects the weighting of the securities by market value (U.S. Dollars) and the corresponding ratings of the underlying securities at the end of 2006 and 2005. The weighted-average rating for those securities was calculated to be “AAA.”

(In thousands)

Credit Rating – Navarro Investments, L.L.C.	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
AAA	\$ 5,692	87.8%	\$ 5,482	90.6%
AA	439	6.8%	565	9.4%
Unrated	350	5.4%	-	-
Total - Navarro Investments, L.L.C.	\$ 6,481	100.0%	\$ 6,047	100.0%

Foreign currency risk – The historical guidelines and the investment policy place a 7.5% of total investment portfolio (fixed-income and equities) limit on the amount that may be invested in foreign-currency-denominated securities. The foreign currency risk is further mitigated by the investment guidelines in the fund.

(In thousands)

Investment Type	December 31, 2006			December 31, 2005		
	Currency	Percentage of Total Portfolio	Market Value	Currency	Percentage of Total Portfolio	Market Value
Foreign bond fund						
Navarro Investments, L.L.C.	\$ *	4.2%	\$ 6,481	\$ *	4.5%	\$ 6,047

*The currencies of the underlying investments include the British Pound, European Euro and Japanese Yen. The weighted-average rating of these securities is calculated to be "AAA."

The Disability Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk and concentration of credit risk. This plan does not hold foreign investments.

Interest rate risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the disability plan.

Concentration of credit risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the disability plan. The following table lists the fixed-income investment holdings by type:

(In thousands)

Investment Type – Disability	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
U.S. Treasuries	\$ 244	15.4%	6.5	\$ 299	19.5%	7.2
U.S. Agencies						
Federal National Mortgage Assn	391	24.7%	4.7	155	10.1%	3.0
Federal Home Loan Mortgage Corp	349	22.1%	3.6	91	6.0%	5.1
Federal Home Loan Bank	50	3.2%	5.5	26	1.7%	5.3
Government National Mortgage Assn	31	1.9%	4.5	35	2.3%	4.5
Corporate bonds	285	18.0%	4.7	654	42.8%	3.7
Total fixed-income investments	1,350	85.3%	4.7	1,260	82.4%	4.6
AIM money market	233	14.7%		269	17.6%	
Total portfolio	\$ 1,583	100.0%		\$ 1,529	100.0%	

Specified fixed-income index:
Lehman Brothers U.S. Aggregate Index

4.5

4.6

Credit risk— In accordance with its historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their portfolio in bonds rated below BBB.

(In thousands)	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – Disability				
U.S. Treasuries	\$ 244	15.4%	\$ 299	19.6%
AAA	1,139	71.9%	950	62.1%
AA	25	1.6%	81	5.3%
A	108	6.8%	82	5.3%
BBB	67	4.3%	67	4.4%
Less than BBB	-	-	50	3.3%
Total fixed-income investments	<u>\$ 1,583</u>	<u>100.0%</u>	<u>\$ 1,529</u>	<u>100.0%</u>

The Life Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk.

Interest rate risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the life plan.

Concentration of credit risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the life plan. The following table lists the fixed-income investment holdings by type:

(In thousands)	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type – Life						
U.S. Treasuries	\$ 1,551	8.7%	7.6	\$ 1,479	8.7%	7.6
U.S. Agencies						
Federal National Mortgage Assn	3,920	22.0%	4.1	2,660	15.6%	3.7
Federal Home Loan Mortgage Corp	3,720	20.9%	3.3	1,255	7.3%	3.7
Government National Mortgage Assn	92	0.5%	1.3	241	1.4%	1.2
Federal Home Loan Bank	74	0.4%	0.7	73	0.4%	1.6
Corporate bonds	4,294	24.1%	5.3	6,900	40.4%	6.5
Foreign bonds	2,395	13.5%	4.4	2,235	13.1%	4.5
Total fixed-income investments	<u>16,046</u>	<u>90.1%</u>	<u>4.6</u>	<u>14,843</u>	<u>86.9%</u>	<u>5.4</u>
AIM money market	1,739	9.9%		2,234	13.1%	
Total portfolio	<u>\$ 17,785</u>	<u>100.0%</u>		<u>\$ 17,077</u>	<u>100.0%</u>	

Specified fixed-income index:

Lehman Brothers U.S. Aggregate Index	4.5	4.6
Citigroup World Government Bond Index	6.0	5.9

Credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their portfolio in bonds rated below BBB.

(In thousands)	December 31, 2006		December 31, 2005	
Credit Rating – Life	Market Value	Allocation	Market Value	Allocation
U.S. Treasuries	\$ 1,551	8.7%	\$ 1,479	8.7%
AAA	11,161	62.8%	11,009	64.5%
AA	816	4.6%	579	3.4%
A	1,357	7.6%	1,658	9.7%
BBB	505	2.8%	17	0.1%
Less than BBB	-	-	100	0.6%
Navarro Investments, L.L.C. - see below	2,395	13.5%	2,235	13.0%
Total fixed-income investments	<u>\$ 17,785</u>	<u>100.0%</u>	<u>\$ 17,077</u>	<u>100.0%</u>

As noted above, even though at the end of calendar years 2006 and 2005, the life plan held approximately 13.5% and 13.0%, respectively, of its fixed-income investments in funds that were not rated by a rating agency, the majority of the underlying securities were rated. The following table reflects the weighting of the securities by market value (U.S. Dollars) and the corresponding ratings of the underlying securities at the end of 2006 and 2005. The weighted-average rating for those securities was calculated to be "AAA."

(In thousands)	December 31, 2006		December 31, 2005	
Credit Rating – Navarro Investments, L.L.C.	Market Value	Allocation	Market Value	Allocation
AAA	\$ 2,104	87.8%	\$ 2,026	90.6%
AA	162	6.8%	209	9.4%
Unrated	129	5.4%	-	-
Total – Navarro Investments, L.L.C.	<u>\$ 2,395</u>	<u>100.0%</u>	<u>\$ 2,235</u>	<u>100.0%</u>

Foreign currency risk – The historical guidelines and the investment policy place a 7.5% of total investment portfolio (fixed-income and equities) limit on the amount that may be invested in foreign-currency-denominated securities. The foreign currency risk is further mitigated by the investment guidelines in the fund.

(In thousands)	December 31, 2006			December 31, 2005		
Investment Type	Currency	Percentage of Total Portfolio	Market Value	Currency	Percentage of Total Portfolio	Market Value
Foreign bond fund						
Navarro Investments, L.L.C.	\$ *	5.1%	\$ 2,395	\$ *	5.1%	\$ 2,235

*The currencies of the underlying investments include the British Pound, European Euro and Japanese Yen. The weighted-average rating of these securities is calculated to be "AAA."

3. Disaggregation of Current Receivables and Payables

Receivables – Net customer accounts receivable as of January 31, 2007, included \$37.6 million for unbilled revenue receivables and \$113.7 million for billed utility services. Interest and other receivables included \$5.1 million for regulatory-related receivables, \$3.7 million for interest receivable and \$13.7 million for other miscellaneous receivables.

Net customer accounts receivable as of January 31, 2006, included \$15.2 million for unbilled revenue receivables and \$101.9 million for billed utility services. Interest and other receivables as of January 31, 2006, included \$16.6 million for the receivables related to the JOA with Texas Genco, \$1.0 million for regulatory-related receivables, \$1.8 million for interest receivable and \$16.7 million for other miscellaneous receivables.

Payables – At January 31, 2007, accounts payable and accrued liabilities included \$209.8 million related to standard operating supplier and vendor payables, including fuels payable; \$35.9 million to employee-related payables; \$22.5 million to the current portion of lease-deferred revenue; \$3.7 million to Employee Benefit Plans; and \$42.8 million to other miscellaneous payables and accrued liabilities.

At January 31, 2006, accounts payable and accrued liabilities included \$152.6 million related to standard operating supplier and vendor payables, including fuels payable; \$41.4 million to employee-related payables; \$22.6 million to the current portion of lease-deferred revenue; \$4.8 million to Employee Benefit Plans; and \$34.8 million to other miscellaneous payables and accrued liabilities.

4. Capital Assets, Net

General Description – CPS Energy's plant-in-service includes seven power plants that are solely owned and operated by the Company. In total, the plants have 19 generating units—three of which are coal-fired and 16 of which are gas-fired. The following is a list of plants and relative generating units:

Plant	Generating Units	Type	Plant	Generating Units	Type
J.T. Deely	2	Coal	V.H. Braunig	3	Gas
J.K. Spruce	1	Coal	W.B. Tuttle	4 *	Gas
Arthur von Rosenberg	1	Gas	Leon Creek	6 *	Gas
O.W. Sommers	2	Gas			

*Included as a part of the 16 gas generating units are W.B. Tuttle Unit 2 and Leon Creek Unit 4, which are fully depreciated and are currently not available for use.

Construction on J.K. Spruce Unit 2 ("Spruce 2") was started on March 21, 2006, with plans for commercial operation in 2010. CPS Energy selected Calaveras Power Partners—a team led by Zachry Construction Corporation of San Antonio—to construct the 750-megawatt coal-fired generating unit at Calaveras Lake. Spruce 2 will be the largest of the coal units at Calaveras Lake, and it will be equipped with current emissions-control technology.

Plant-in-service also includes CPS Energy's 40% interest in STP. Other notable capital assets in electric and gas plant include a fleet of rail cars, a transmission network for the movement of electric power from the generating stations, and electric and gas distribution systems.

Included in general plant are the Energy Management Center; the main office complex; the North Side Customer Service Center; the construction and customer service centers; the Villita Assembly Building; and a fleet of automobiles, trucks and work equipment.

Impairments – An internal company-wide review of capital assets, in accordance with GASB Statement No. 42, indicated that CPS Energy had no impaired capital assets for FY 2007. Additionally, there were no impaired capital assets for FY 2006.

Investment in STP – STP is a two-unit nuclear power plant located in Matagorda County, Texas. It is maintained and operated by the STP Nuclear Operating Company (a nonprofit Texas corporation) and is financed and controlled by the owners—CPS Energy, NRG Energy, Inc. and the City of Austin. Also see Note 13 – South Texas Project.

To achieve the 40% interest in STP, CPS Energy exercised its right of first refusal to acquire an additional 12% (300 megawatts) share from a prior owner. The purchase was completed May 19, 2005, and increased CPS Energy's proportionate share of STP from 28% to 40%.

STP Capital Investment (40% share), Net

	January 31,	
	2007	2006
	(In thousands)	
STP capital assets (40% share), net		
Construction-in-progress	\$ 30,966	\$ 21,261
Land	5,701	5,701
Electric and general plant	1,376,023	1,417,016
Nuclear fuel	69,976	59,470
Total STP capital assets (40% share), net	<u>\$ 1,482,666</u>	<u>\$ 1,503,448</u>
Total CPS Energy assets, net	<u>\$ 5,294,792</u>	<u>\$ 4,942,636</u>
STP capital investment as a percentage of total CPS Energy capital assets, net	28.0%	30.4%

Capital Asset Rollforward – Below is a detail of the activity of CPS Energy's Net Capital Assets as presented on the Balance Sheets, including capital asset activity for the fiscal years ended January 31, 2007, and January 31, 2006:

FY 2007 Capital Asset Rollforward

(In thousands)

	Balance February 1, 2006	Additions/ Increases	Transfers In/ (Out)	(Reductions)/ (Decreases)	Balance January 31, 2007
Nondepreciable assets					
Land	\$ 58,651	\$ -	\$ 1,429	\$ -	\$ 60,080
Nonutility land	12,599	-	-	-	12,599
Construction-in-progress	296,946	546,009	(423,160)	-	419,795
Total nondepreciable assets	368,196	546,009	(421,731)	-	492,474
Depreciable assets					
Electric plant	6,259,022	36,801	335,897	(32,269)	6,599,451
Gas plant	574,138	3,827	22,201	1,287	601,453
General plant	540,008	13,625	63,633	(9,482)	607,784
Utility property leased	18,785	-	-	-	18,785
Nuclear fuel	485,055	36,174	-	-	521,229
Total depreciable assets	7,877,008	90,427	421,731	(40,464)	8,348,702
Accumulated depreciation, depletion and amortization					
Electric plant	(2,530,472)	(214,410)	-	36,407	(2,708,475)
Gas plant	(191,045)	(12,966)	-	(1,065)	(205,076)
General plant	(155,130)	(34,495)	-	8,885	(180,740)
Utility property leased	(336)	(504)	-	-	(840)
Nuclear fuel	(425,585)	(25,668)	-	-	(451,253)
Total accumulated depreciation, depletion and amortization	(3,302,568)	(288,043)	-	44,227	(3,546,384)
Capital assets, net	\$ 4,942,636	\$ 348,393	\$ -	\$ 3,763	\$ 5,294,792

Cash flow information – Cash paid for additions, net removal costs and nuclear fuel was \$623,739, and noncash AFUDC was \$16,460, for a total of \$640,199. Included in Reductions/Decreases was \$7,500 in removal costs, offset by \$3,737 in salvage sales. Depreciation and depletion totaled \$288,043.

Other – The increases in electric plant also included new substations and distribution infrastructure.

FY 2006 Capital Asset Rollforward

(In thousands)

	Balance February 1, 2005	Additions/ Increases	Transfers In/ (Out)	(Reductions)/ (Decreases)	Balance January 31, 2006
Nondepreciable assets					
Land	\$ 56,482	\$ 535	\$ 1,634	\$ -	\$ 58,651
Nonutility land	12,599	-	-	-	12,599
Construction-in-progress	180,594	335,977	(219,625)	-	296,946
Total nondepreciable assets	249,675	336,512	(217,991)	-	368,196
Depreciable assets					
Electric plant	5,977,120	167,447	167,787	(53,332)	6,259,022
Gas plant	496,470	2,664	30,210	44,794	574,138
General plant	531,810	8,745	19,994	(20,541)	540,008
Utility property leased	18,785	-	-	-	18,785
Nuclear fuel	319,186	45,636	120,233	-	485,055
Total depreciable assets	7,343,371	224,492	338,224	(29,079)	7,877,008
Accumulated depreciation, depletion and amortization					
Electric plant	(2,349,009)	(202,781)	-	21,318	(2,530,472)
Gas plant	(171,370)	(11,022)	-	(8,653)	(191,045)
General plant	(142,540)	(32,607)	-	20,017	(155,130)
Utility property leased	(336)	-	-	-	(336)
Nuclear fuel	(283,797)	(21,555)	(120,233)	-	(425,585)
Total accumulated depreciation, depletion and amortization	(2,947,052)	(267,965)	(120,233)	32,682	(3,302,568)
Capital assets, net	\$ 4,645,994	\$ 293,039	\$ -	\$ 3,603	\$ 4,942,636

Cash flow information – Cash paid for additions, net removal costs and nuclear fuel was \$559,938, and noncash AFUDC was \$4,669, for a total of \$564,607. Included in Reductions/Decreases was \$6,715 in removal costs, offset by \$3,112 in salvage sales. Depreciation and depletion totaled \$267,965.

Other – The \$120,233 under Transfers In/ (Out) represents the addition of nuclear fuel and its amortization as acquired through the additional 12% purchase of STP. The increases in electric plant also included the 12% STP acquisition, as well as new substations and distribution infrastructure. The STP acquisition is included in the electric plant Additions/Increases column. Included in electric plant was the Mission Road generation plant ("MRP") that had an acquisition value of \$12.5 million. MRP was taken out of service on October 1, 2003, after being fully depreciated.

5. Revenue Bond and Commercial Paper Ordinances Requirements

Senior Lien – As of January 31, 2007, the bond ordinances for New Series Bonds issued on and after February 1, 1994, contained, among others, the following provisions:

Revenue deposited in CPS Energy's General Account shall be pledged and appropriated to be used in the following priority for:

- Maintenance and operating expenses of the electric and gas systems ("Systems");
- Payments of the New Series Bonds;
- Payment of Prior Lien Bonds, including Junior Lien Obligations;
- Payment of the Notes and the Credit Agreement (as defined in the ordinance authorizing Commercial Paper);
- Payment of any Inferior Lien Obligations issued, which are inferior in lien to the New Series Bonds, the Prior Lien Bonds and the Notes and Credit Agreement;

- An annual amount equal to 6% of the gross revenue of the Systems to be deposited in the Repair and Replacement Account;
- Cash payments and benefits to the General Fund of the City not to exceed 14% of the gross revenue of the Systems; and
- Any remaining net revenues of the Systems in the General Account to the Repair and Replacement Account.

The maximum amount in cash to be transferred or credited to the City's General Fund from the net revenues of the Systems during any fiscal year shall not exceed 14% of the gross revenues of the Systems, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the fiscal year for additions to the street lighting system. The percentage of gross revenues of the Systems to be paid over, or credited to, the City's General Fund each fiscal year shall be determined (within the 14% limitation) by the governing body of the City.

The net revenues of the Systems are pledged to the payment of principal of and interest on the New Series Bonds, which are classified as Senior Lien Obligations. All New Series Bonds and the interest thereon shall have a first lien upon the net revenues of the Systems.

Junior Lien – The Junior Lien, Variable Rate Demand Obligation ("VRDO") bonds are debt instruments of the City payable solely from, and equally and ratably secured by, a junior lien on and pledge of the net revenues of the Systems, subject and subordinate to liens and pledges securing the outstanding Senior Lien Obligations and any additional Senior Lien Obligations hereafter issued, and superior to the pledge and lien securing the currently outstanding Commercial Paper Obligations, all as fully set forth in the ordinances authorizing the issuance of the Junior Lien Obligations as noted below:

The City agrees that it will at all times maintain rates and charges for the sale of electric energy, gas or other services furnished, provided and supplied by the Systems to the City and all other consumers, which shall be reasonable and nondiscriminatory and which will produce income and revenues sufficient to pay:

- All maintenance and operating expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502 of the Texas Government Code, as amended;
- The interest on, and principal of, all Parity Bonds, as defined in the New Series Bond Ordinances, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Parity Bonds;
- The interest on, and principal of, the Prior Lien Bonds, including the Junior Lien Obligations and any additional Junior Lien Obligations hereafter issued (all as defined in the New Series Bond Ordinances), as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Junior Lien Obligations and any additional Junior Lien Obligations;
- To the extent the same are reasonably anticipated to be paid with available revenues (as defined in the Ordinance authorizing the Commercial Paper), the interest on and principal of all Notes (as defined in said Ordinance), and the Credit Agreement (as defined in said Ordinance); and
- Any legal debt or obligation of the Systems as and when the same shall become due.

Tax-Exempt Commercial Paper ("TECP") – As of January 31, 2007, the TECP Ordinance contains, among others, the following provisions:

To secure the payment of TECP principal and interest, a pledge is made of:

- Proceeds from
 - The sale of bonds and additional notes issued for such purposes, and
 - The sale of TECP;
- Loans under and pursuant to the revolving credit agreement; and
- The net revenues of the Systems, after payment on New Series Bond requirements and Prior Lien Bond Obligations.

Compliance – As of January 31, 2007, and January 31, 2006, CPS Energy was in compliance with the terms of the New Series Bonds, the Junior Lien Obligations and the TECP Ordinances.

6. Revenue Bonds

On August 31, 2006, CPS Energy issued \$384.2 million of tax-exempt New Series 2006A Revenue Bonds. These bonds were partially used to reimburse the Repair and Replacement Account for construction expenditures made during the months of February through July 2006 in the amount of \$131.2 million. The \$268.8 million remaining proceeds and net original issue premium will be used to fund generation, as well as electric and gas distribution construction projects.

On August 11, 2006, \$106.4 million of New Series 1997 Revenue and Refunding Bonds were legally defeased with cash. Under this defeasance, the debt obligations have been technically voided, as an appropriate level of cash has been set aside in escrow to service the debt. As a result, an accounting loss of \$7.2 million was recorded. The basis of the loss calculation included \$107.8 million paid for the actual defeasance; less the par value of debt outstanding; plus unamortized bond issue, reacquisition and discount costs.

On October 27, 2005, CPS Energy issued \$197.3 million of tax-exempt New Series 2005A Bonds. The true interest cost of these bonds was 4.6%. CPS Energy received net proceeds of \$201.5 million from the issuance of these bonds. Of this amount, \$200.0 million was used to retire commercial paper, with the remaining used to pay costs and expenses relating to the issuance of the bonds. See Note 7 – Commercial Paper.

On April 13, 2005, CPS Energy issued \$535.3 million of tax-exempt New Series 2005 Bonds. Included were par amounts of \$294.6 million of Revenue Refunding Bonds and \$240.7 million of Revenue Bonds. The true interest cost of these bonds was 4.5%. CPS Energy received net proceeds of \$250.0 million from the issuance of the Revenue Bonds. Proceeds were used to fund transmission, electric distribution, information technology and communication, and general property construction. Refunding of higher cost outstanding bonds resulted in net present value debt service savings of \$19.7 million, or 6.7% of the par amount of the refunded bonds. This transaction resulted in a loss for accounting purposes of \$14.3 million, which has been deferred and is being amortized over the shorter life of either the refunded or refunding bonds.

Revenue Bond Summary

Maturities	Weighted-Average Yield on Outstanding Bonds at January 31, 2007	January 31,	
		2007	2006
(In thousands)			
Tax-exempt new series			
bonds 1994A–2006A, 2008–2025	4.8%	\$ 2,578,485	\$ 2,429,645
Taxable new series			
bonds 1998 & 2000, 2008–2021	6.7%	125,370	131,240
Total	4.8%	2,703,855	2,560,885
Tax-exempt variable rate series			
bonds 2003–2004, 2024–2033		407,000	407,000
Total long-term revenue bonds outstanding		3,110,855	2,967,885
Less: Current maturities of bonds		141,755	135,155
Total revenue bonds outstanding, net of current maturities		\$ 2,969,100	\$ 2,832,730

As of January 31, 2007, principal and interest amounts due for all revenue bonds outstanding for each of the next five years and thereafter to maturity are:

(In thousands)			
Year	Principal	Interest	Total
2008	\$ 141,755	\$ 152,493	\$ 294,248
2009	151,225	145,274	296,499
2010	148,170	137,495	285,665
2011	161,805	129,735	291,540
2012	175,900	121,216	297,116
2013-2017	722,290	473,450	1,195,740
2018-2022	717,340	300,127	1,017,467
2023-2027	603,120	121,159	724,279
2028-2032	239,250	39,188	278,438
2033	50,000	1,770	51,770
Totals	<u>\$ 3,110,855</u>	<u>\$ 1,621,907</u>	<u>\$ 4,732,762</u>

The above table includes Senior Lien and Junior Lien Bonds. Interest on the Senior Lien Bonds is based upon the stated coupon rates of each series of bonds outstanding. The 2003 Junior Lien Bonds were issued as variable-rate bonds and as such have interest rates that reset on a weekly basis. On December 1, 2005, the 2004 Junior Lien Bonds were remarketed for a two-year term at an interest rate of 3.6%. This interest rate will remain in effect until the next interest reset date of December 1, 2007. The total interest amounts for all revenue bonds outstanding included a blended interest rate of 3.5% for the 2003 and 2004 Junior Lien Bonds.

The interest rate term mode for the Junior Lien Revenue Bonds, or any portion thereof, may be converted to a different mode, or to an auction rate or term rate with an interest rate period of different duration, at the direction of the City. Following such a conversion, the Junior Lien Revenue Bonds, or portion thereof, will bear interest at the corresponding daily rate, weekly rate, auction rate, commercial paper rate, term rate or fixed rate.

FY 2007 Long-Term Debt Activity

(In thousands)	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-06	Additions During Year	(Decreases) During Year	Balance Outstanding 1-31-07
Revenue and refunding bonds							
1994A tax-exempt	\$ 684,700	2012	5.008	\$ 68,965	\$ -	\$ -	\$ 68,965
1995 tax-exempt	125,000	2007	5.500	5,800	-	(5,800)	-
1997 tax-exempt	350,000	2020	5.738	4,085	-	(4,085)	-
1997 tax-exempt	311,170	2014	5.509	102,355	-	(102,355)	-
1998A tax-exempt	785,515	2021	4.918	550,040	-	(34,545)	515,495
1998B taxable	99,615	2020	6.343	87,815	-	(4,175)	83,640
2000A tax-exempt	170,770	2010	5.374	11,170	-	(3,080)	8,090
2000B taxable	50,425	2021	7.403	43,425	-	(1,695)	41,730
2001 tax-exempt	115,280	2011	3.843	106,430	-	(21,400)	85,030
2002 tax-exempt	436,090	2017	4.055	436,090	-	-	436,090
2002 tax-exempt	140,615	2015	4.751	10,525	-	-	10,525
2003 tax-exempt - Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	89,150	-	(7,000)	82,150
2003 tax-exempt	350,490	2013	3.081	312,400	-	(57,080)	255,320
2004 tax-exempt - Junior Lien	160,000	2027	Variable	157,000	-	-	157,000
2005 tax-exempt	294,625	2020	4.381	294,625	-	-	294,625
2005 tax-exempt	240,675	2025	4.683	240,675	-	-	240,675
2005A tax-exempt	197,335	2025	4.571	197,335	-	-	197,335
2006A tax-exempt	384,185	2025	4.555	-	384,185	-	384,185
Bonds outstanding				2,967,885	384,185	(241,215)	3,110,855
Bond current maturities				(135,155)	(6,600)		(141,755)
Bond (discount) premium				102,164	18,447	(16,399)	104,212
Bond reacquisition costs				(121,298)	-	25,537	(95,761)
Revenue bonds, net				2,813,596	396,032	(232,077)	2,977,551
Tax-exempt commercial paper			Variable	150,000	200,000	-	350,000
Long-term debt, net				\$ 2,963,596	\$ 596,032	\$ (232,077)	\$ 3,327,551

FY 2006 Long-Term Debt Activity

(In thousands)	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-05	Additions During Year	(Decreases) During Year	Balance Outstanding 1-31-06
Revenue and refunding bonds							
1992 tax-exempt	\$ 700,805	2006	6.048	\$ 36,875	\$ -	\$ (36,875)	\$ -
1994A tax-exempt	684,700	2012	5.008	68,965	-	-	68,965
1994C tax-exempt	56,000	2006	5.008	42,710	-	(42,710)	-
1995 tax-exempt	125,000	2007	5.500	11,300	-	(5,500)	5,800
1997 tax-exempt	350,000	2020	5.738	169,715	-	(165,630)	4,085
1997 tax-exempt	311,170	2014	5.509	102,715	-	(360)	102,355
1998A tax-exempt	785,515	2021	4.918	582,965	-	(32,925)	550,040
1998B taxable	99,615	2020	6.343	89,870	-	(2,055)	87,815
2000A tax-exempt	170,770	2010	5.374	15,795	-	(4,625)	11,170
2000B taxable	50,425	2021	7.403	45,010	-	(1,585)	43,425
2001 tax-exempt	115,280	2011	3.843	106,430	-	-	106,430
2002 tax-exempt	436,090	2017	4.055	436,090	-	-	436,090
2002 tax-exempt	140,615	2020	4.751	140,615	-	(130,090)	10,525
2003 tax-exempt – Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	89,770	-	(620)	89,150
2003 tax-exempt	350,490	2013	3.081	312,400	-	-	312,400
2004 tax-exempt – Junior Lien	160,000	2027	Variable	160,000	-	(3,000)	157,000
2005 tax-exempt	294,625	2020	4.381	-	294,625	-	294,625
2005 tax-exempt	240,675	2025	4.683	-	240,675	-	240,675
2005A tax-exempt	197,335	2025	4.571	-	197,335	-	197,335
Bonds outstanding				2,661,225	732,635	(425,975)	2,967,885
Bond current maturities				(127,255)	(7,900)	-	(135,155)
Bond (discount) premium				89,149	34,438	(21,423)	102,164
Bond reacquisition costs				(134,227)	(9,714)	22,643	(121,298)
Revenue bonds, net				2,488,892	749,459	(424,755)	2,813,596
Tax-exempt commercial paper			Variable	350,000	-	(200,000)	150,000
Long-term debt, net				<u>\$ 2,838,892</u>	<u>\$ 749,459</u>	<u>\$ (624,755)</u>	<u>\$ 2,963,596</u>

On February 8, 2007, CPS Energy issued \$128.9 million of tax-exempt New Series 2006B Revenue Refunding Bonds. The true interest cost on these bonds was approximately 4.0%. On February 9, 2007, the bond proceeds were used to refund \$77.1 million par value of the taxable New Series 1998B Bonds and \$41.7 million par value of the taxable New Series 2000B Bonds. At that time, CPS Energy cash defeased \$6.5 million par value of the taxable New Series 1998B Bonds that could not be advance refunded with tax-exempt debt. The refunding transaction resulted in net present value debt service savings of \$6.7 million, or approximately 5.3% of the par amount of the bonds refunded.

7. Commercial Paper

In 1988, the City Council of San Antonio, Texas adopted an ordinance authorizing the issuance of up to \$300.0 million in TECP. This ordinance, as amended in June 1997, provides for funding to assist in the financing of eligible projects in an aggregate amount not to exceed \$450.0 million. Eligible projects include fuel acquisition, capital improvements to the utility systems, and refinancing or refunding any outstanding obligations, which are secured by and payable from a lien and/or a pledge of net revenues of the Systems. The program's scheduled maximum maturities cannot extend beyond November 1, 2028.

The TECP has been classified as long-term in accordance with the refinancing terms under a revolving credit agreement with a consortium of banks, which supports the commercial paper. Under the terms of the revolving credit agreement, CPS Energy may borrow up to an aggregate amount not to exceed

\$350.0 million for the purpose of paying principal due under the TECP. The revolving credit agreement is currently extended until November 1, 2010, and may be renewed for an additional year.

As of January 31, 2007, there have been no borrowings under the revolving credit agreement. The TECP is secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of existing New Series Bonds and Junior Lien Obligations.

CPS Energy issued \$200.0 million of TECP on August 24, 2006. These proceeds will be used to fund generation, as well as electric and gas distribution construction projects. The current outstanding TECP balance as of January 31, 2007, is \$350.0 million.

On October 27, 2005, CPS Energy issued \$197.3 million of New Series 2005A Revenue Refunding Bonds to redeem \$200.0 million of the outstanding TECP, as shown in Note 6 – Revenue Bonds. The TECP balance outstanding was \$150.0 million at January 31, 2006.

TECP Summary

(In thousands)	January 31,	
	2007	2006
TECP outstanding	\$ 350,000	\$ 150,000
TECP new money issues	200,000	-
Weighted-average interest rate of outstanding TECP	3.6%	3.1%
Average life of outstanding TECP (number of days)	90	96

8. Employee Pension Plan

The CPS Energy Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan ("Plan") covering substantially all employees who have completed one year of service. It is an unconsolidated entity within which normal retirement is age 65; however, early retirement is available with 25 years of benefit service, as well as to those employees who are ages 55 or older with at least ten years of benefit service.

Plan Participants Summary

	Plan (Calendar) Year Date - January 1,		
	2006	2005	2004
Retirees and beneficiaries currently receiving benefits	1,477	1,399	1,324
Terminated employees not yet receiving earned benefits	50	27	20
Current employees participating in Plan	3,779	3,902	3,926
Total	5,306	5,328	5,270

Retirement benefits are based on length of service and compensation, and benefits are reduced for retirement before age 55 with 25 years or more of benefit service or age 62 with less than 25 years of service. The Plan is sponsored by and may be amended by CPS Energy. Plan net assets, having a market value of \$1.1 billion at December 31, 2006; \$995.2 million at December 31, 2005; and \$978.6 million

at December 31, 2004, are held in a separate trust that is audited annually and in which statements include historical trend information. For further information, contact Compensation and Employee Benefits at CPS Energy.

The current policy of CPS Energy is to establish funding levels, considering annual actuarial evaluations and recommendations of the Administrative Committee, using both employee and employer contributions. Generally, participating employees contribute 5.0% of their total compensation and are normally fully vested in CPS Energy's contribution after completing seven years of credited service or at age 40.

Employee contributions commence with the effective date of participation and continue until attaining normal or early retirement age, completion of 44 years of benefit service or termination of employment. The balance of Plan contributions is the responsibility of CPS Energy, giving consideration to actuarial information, budget controls, legal requirements, compliance, and industry and/or community norms.

CPS Energy adopted a Restoration Plan effective January 1, 1998, to supplement benefits paid from the Plan due to federal tax restrictions on benefit amounts. The benefits due under the Restoration Plan have been paid annually by CPS Energy.

The total employer and employee pension funding, which includes amortization of past service costs using the unit credit cost actuarial method, is summarized as follows:

Pension Funding

(In thousands)	Fiscal Year Ended January 31,		
	2007	2006	2005
Employee contributions	\$ 10,005	\$ 9,570	\$ 9,215
Company contributions	9,626	7,131	8,160
Total contributions	<u>\$ 19,631</u>	<u>\$ 16,701</u>	<u>\$ 17,375</u>
Covered payroll	<u>\$ 210,074</u>	<u>\$ 198,441</u>	<u>\$ 189,892</u>
Total payroll	<u>\$ 221,456</u>	<u>\$ 206,800</u>	<u>\$ 198,648</u>

The pension plan assets are reported on a calendar-year basis; therefore, the actuarial tables are reported accordingly. The Pension Funding Progress and Pension Obligation tables below are not a required part of the basic financial statements but are required supplementary information (RSI) in accordance with U.S. generally accepted accounting principles.

The actuarially determined contribution requirements for calendar years 2007, 2006 and 2005 were computed using an assumed rate of return of 8.0%. The past service costs for 2007 and 2006 were amortized over a targeted 15 years versus a ten-year target for 2005. There were no changes in actuarial assumptions or in the actuarial cost method used for the 2007 valuation from those used for the 2006 valuation.

The employee contribution interest crediting rate was 8.0% for 2007. For 2006, it was reduced from 8.5% to 8.0%, with a negligible impact on actuarial valuation results. CPS Energy's company

contributions to the Plan amounted to 4.4% of covered payroll in FY 2007, 3.6% in FY 2006 and 4.3% in FY 2005.

Pension Funding Progress (RSI - Unaudited)

(In millions)	Plan (Calendar) Year Actuarial Valuation Date - January 1,					
	2006	2005	2004	2003	2002	2001
1. Actuarial value of assets	\$ 955.3	\$ 902.1	\$ 839.8	\$ 783.0	\$ 758.2	\$ 713.6
2. Actuarial accrued liability (AAL)	906.4	837.6	795.1	748.7	691.8	643.5
3. (Overfunded)/Unfunded AAL:						
(2) - (1)	\$ (48.9)	\$ (64.5)	\$ (44.7)	\$ (34.3)	\$ (66.4)	\$ (70.1)
4. Funded ratio (1) ÷ (2)	105.4%	107.7%	105.6%	104.6%	109.6%	110.9%
5. Covered payroll	\$ 210.1	\$ 198.4	\$ 189.9	\$ 186.7	\$ 180.3	\$ 165.3
6. (Overfunded)/Unfunded AAL as a percentage of covered payroll: (3) ÷ (5)	-23.3%	-32.5%	-23.5%	-18.4%	-36.8%	-42.4%

Actuarial valuation methods used for January 1, 2006, 2005 and 2004 included (a) the five-year smoothed market for asset valuation, (b) the projected unit credit for actuarial accrued liability, and (c) the level dollar open for amortization of pension service costs. The remaining amortization periods for January 1, 2006, 2005 and 2004 were 29.4 years, 24.4 years and 21.6 years, respectively, and were calculated using the level dollar open amortization method.

Significant actuarial assumptions used for the January 1, 2006, actuarial valuation included (a) a rate of return on the investment of present and future assets of 8.0%, (b) projected salary increases averaging 4.1%, and (c) post retirement cost-of-living increases of 1.8%. The projected salary increases included an inflation rate of 3.5%. CPS Energy's pension cost and net pension obligation for the fiscal years ended January 31, 2007, 2006 and 2005, were as follows:

Pension Obligation (RSI - Unaudited)

(In thousands)	Fiscal Year Ended January 31,		
	2007	2006	2005
Annual required contribution ("ARC")	\$ 10,051	\$ 7,162	\$ 8,694
Less company contributions in relation to ARC	10,051	7,162	8,694
Net pension obligation - end of year	\$ -	\$ -	\$ -
Percentage of ARC contributed	100%	100%	100%

Employees who retired prior to 1983 receive annuity payments from an insurance carrier, as well as some benefits directly from CPS Energy. The costs for the benefits directly received from CPS Energy were \$175.6 thousand, \$222.6 thousand and \$224.3 thousand for the fiscal years ended January 31, 2007, 2006 and 2005, respectively. These costs were recorded when paid.

See Note 13 - South Texas Project for information on the STP Pension Plan.

9. Employee and Other Postemployment Benefits

The following table represents total claims payable by CPS Energy to the three Employee Benefit Plans combined:

(In thousands)	Fiscal Year ended January 31,	
	2007	2006
Beginning claims payable	\$ 4,597	\$ 5,259
Payments	(36,506)	(38,741)
Incurred claims	35,357	38,079
Ending claims payable	<u>\$ 3,448</u>	<u>\$ 4,597</u>

Plan Description – CPS Energy provides certain health and life insurance benefits for employees. Additionally, most CPS Energy employees are also eligible for these benefits upon retirement from the Company. Assets of the plans are held in three separate, single-employer contributory plans:

- City Public Service of San Antonio Group Health Plan (“health plan”)
- City Public Service of San Antonio Group Disability Plan (“disability plan”)
- City Public Service of San Antonio Group Life Insurance Plan (“life plan”)

The Employee Benefit Plans’ assets are segregated from CPS Energy’s assets. They are separately managed by a committee whose members are appointed by the CPS Energy General Manager and CEO. These plans report results on a calendar-year basis and issue separately audited financial statements that may be obtained by contacting Compensation and Employee Benefits at CPS Energy.

Basis of Accounting – The financial statements of each of the three Employee Benefit Plans are prepared using the accrual basis of accounting in conformity with U.S. GAAP. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plans apply all GASB pronouncements as well as FASB pronouncements, issued on or before November 30, 1989, unless those FASB pronouncements conflict with or contradict GASB pronouncements.

Funding – Funding of the plans is from both participant and employer contributions determined by annual actuarial and in-house calculations. Retired employees contribute to the health plan in varying amounts depending upon an equity formula that considers age and years of service. The plan may be amended by CPS Energy. The annual cost of retiree health and life insurance benefits funded by CPS Energy is recognized as an expense of CPS Energy as employer contributions are made to the programs. These retiree costs approximated \$7.0 million and \$5.7 million for the fiscal years ended January 31, 2007 and 2006, respectively. CPS Energy reimbursed a percentage of the monthly premium to certain retirees and their spouses enrolled in Medicare Part B. Costs for this reimbursement were \$451.5 thousand and \$413.8 thousand for the fiscal years ended January 31, 2007 and 2006, respectively.

Retired employees and covered dependents contributed \$3.2 million for their health and life insurance benefits in FY 2007 and \$2.5 million in FY 2006. In FY 2007, there were 2,502 retirees and covered dependents eligible for health and life insurance benefits, as compared to 2,473 in FY 2006.

The Medicare Prescription Drug Improvement and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D entitled the health plan to receive retiree drug subsidy

payments from the federal government to offset pharmacy claims paid by the health plan on behalf of certain plan participants. The plan began receiving subsidy payments in the third quarter of FY 2007; these payments totaled \$598.2 thousand as of January 31, 2007. In accordance with GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*, future projected payments from the federal government have not been used to lessen total projected obligations under the Company's plan.

Actuarial Valuation – In view of the potential economic significance of these benefits, CPS Energy has reviewed the present value of the postemployment benefit obligations for current retirees. The January 1 valuations were \$101.6 million for 2006 and \$104.5 million for 2005 for health benefits and \$27.0 million for 2006 and \$25.0 million for 2005 for life insurance benefits. The actuarial analysis of the present value of postemployment benefit obligations for all active employees is estimated to be \$126.8 million for health, \$33.9 million for life insurance and \$6.0 million for disability benefits. CPS Energy began partial accrual and funding of projected future benefits in 1992. Funding totaled \$3.2 million in FY 2007, \$4.2 million in FY 2006 and \$5.2 million in FY 2005.

For the health plan, the actuarial cost method used was the Projected Unit Credit Actuarial Cost Method. For the life insurance and disability plans, CPS Energy used a present-value method to determine the cost of benefits.

Significant actuarial assumptions used in the calculations for January 1, 2006, included (a) a rate of return on the investment of present and future assets of 8.0% for the health, life and disability plans, (b) projected salary increases for the plans ranging from 4.5% to 12.0% depending on age for base and other salaries, and (c) medical cost increases projected at 10.0% for 2006, decreasing to 5.5% in 2016 and thereafter.

Health Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
1/1/2004	\$109,486	\$199,076	\$ 89,590	55.0%	\$189,892	47.2%
1/1/2005	121,700	233,280	111,580	52.2%	198,441	56.2%
1/1/2006	133,851	228,446	94,595	58.6%	210,074	45.0%

*The actuarial accrued liability consisted of the liability for both retired employees and active employees. The actuarial accrued liability for retired employees was \$101.6 million for January 1, 2006; \$104.5 million for January 1, 2005; and \$80.5 million for January 1, 2004.

Disability Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date*	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
1/1/2006	\$4,109	\$6,000	\$ 1,891	68.5%	\$210,074	0.9%

*Per GASB Statement 43, the Actuarial Accrued Liability is not being reported for the Actuarial Valuation Dates of 1/1/2005 and 1/1/2004 since they were not calculated in accordance with this Statement.

Life Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
1/1/2004	\$41,979	\$52,309	\$ 10,330	80.3%	\$189,892	5.4%
1/1/2005	44,174	58,021	13,847	76.1%	198,441	7.0%
1/1/2006	46,662	60,903	14,241	76.6%	210,074	6.8%

*The actuarial accrued liability consisted of the liability for both retired employees and active employees. The actuarial accrued liability for retired employees was \$27.0 million for January 1, 2006; \$25.0 million for January 1, 2005; and \$21.8 million for January 1, 2004.

10. Other Obligations and Risk Management

Other Liabilities & Deferred Credits – CPS Energy maintains other obligations as noted below. The relative long-term portion of these obligations compared to the total as of January 31, 2007, and January 31, 2006, was 97.8% and 97.7%, respectively.

FY 2007 Other Liabilities & Deferred Credits

(In thousands)	Rollforward			Total	
	Balance	Additions	(Decreases)	Balance	Long-Term
	Outstanding 2-1-2006			Outstanding 1-31-2007	Balance Outstanding
Customer deposits	\$ 22,363	\$ 18,397	\$ (15,975)	\$ 24,785	\$ 24,785
Decommissioning trusts	301,072	154,113	(7,028)	448,157	448,157
Deferred lease revenue (long-term)	588,454	-	(22,560)	565,894	543,333
	911,889	172,510	(45,563)	1,038,836	1,016,275
Other					
Insurance reserves	12,781	11,924	(12,294)	12,411	10,462
STP pension and other postemployment benefits	25,209	14,638	(10,145)	29,702	29,702
Project Warm	7,522	272	(107)	7,687	7,687
Notes payable	5,349	-	(374)	4,975	4,395
Customer advances	25,924	29,620	(24,681)	30,863	30,863
Deferred credits	17,186	72,979	(79,494)	10,671	10,671
Other	600	-	(37)	563	563
Total other liabilities	94,571	129,433	(127,132)	96,872	94,343
Total other long-term liabilities & deferred credits	\$ 1,006,460	\$ 301,943	\$ (172,695)	\$ 1,135,708	\$ 1,110,618

FY 2006 Other Liabilities & Deferred Credits

(In thousands)	Rollforward			Total	
	Balance	Additions	(Decreases)	Balance	Long-Term
	Outstanding 2-1-2005			Outstanding 1-31-2006	Balance Outstanding
Customer deposits	\$ 19,419	\$ 15,708	\$ (12,764)	\$ 22,363	\$ 22,363
Decommissioning trusts	222,410	78,662	-	301,072	301,072
Deferred lease revenue (long-term)	611,015	-	(22,561)	588,454	565,893
	852,844	94,370	(35,325)	911,889	889,328
Other					
Insurance reserves	12,880	5,634	(5,733)	12,781	12,781
STP pension and other postemployment benefits	13,925	11,578	(294)	25,209	25,209
STP fuel assessment	655	280	(935)	-	-
Project Warm	7,583	601	(662)	7,522	7,522
Notes payable	5,800	-	(451)	5,349	4,889
Customer advances	23,793	23,463	(21,332)	25,924	25,924
Deferred credits	1,446	47,058	(31,318)	17,186	17,186
Other	598	21	(19)	600	600
Total other liabilities	66,680	88,635	(60,744)	94,571	94,111
Total other long-term liabilities & deferred credits	\$ 919,524	\$ 183,005	\$ (96,069)	\$ 1,006,460	\$ 983,439

Reserves – CPS Energy is exposed to various risks of loss including, but not limited to, those related to torts, theft or destruction of assets, errors and omissions, and natural disasters. CPS Energy maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major risks. The property insurance program provides \$4.3 billion of replacement-value coverage for property and boiler machinery loss, including comprehensive automobile coverage, fire damage coverage for construction equipment and valuable papers coverage. The deductible for the property insurance policy is \$5.0 million for general property and turbine generators/transformers. The liability insurance program includes:

- \$100.0 million of excess general liability coverage over a retention amount of \$2.0 million;
- \$25.0 million of fiduciary liability coverage; and
- Other property and liability insurance coverage, which includes employee travel, event insurance and commercial crime.

Actuarial studies are performed periodically to assess and determine the adequacy of insurance reserve retentions. An actuarial study was performed in the third quarter of FY 2007.

The remaining property reserve balance at January 31, 2007, related to estimated obligations for the cleanup, closure and post-closure care requirements of the Company's landfills. CPS Energy has seven landfill sites—four of which are at full capacity. The estimates for landfill liability are based upon capacity to date and are subject to change due to inflation or deflation, as well as new developments in technology, applicable laws or regulations.

CPS Energy also manages its own workers' compensation program. Additionally, to support this program, \$35.0 million of excess workers' compensation coverage over a retention amount of \$2.0 million is maintained.

Beginning in FY 2007, our reserve program was modified to record all claims against the reserve, whereas in prior years only significant claims were recorded against the reserve.

(In thousands)	Reserve Rollforward		
	Employee & Public Liability Claims	Property Reserves	Total Insurance Reserves
Balance – FY 2005	\$ 6,035	\$ 6,845	\$ 12,880
Payments	(341)	-	(341)
Incurred claims	-	-	-
Other claims adjustments	3,449	(3,208)	241
Balance – FY 2006	\$ 9,143	\$ 3,637	\$ 12,780
Payments	(2,590)	-	(2,590)
Incurred claims	-	-	-
Other claims adjustments	2,118	101	2,219
Balance – FY 2007	\$ 8,671	\$ 3,738	\$ 12,409

11. Other Financial Instruments

Hedging – The 1999 Texas utility deregulation legislation, Senate Bill 7, contained provisions modifying the PFIA to allow municipal utilities the ability to purchase and sell energy-related financial instruments in order to hedge or mitigate the effect of market price fluctuations of natural gas, fuel oil and electric energy.

On July 31, 2006, the CPS Energy Board of Trustees reaffirmed the Energy Price Risk Management Policy, which sets forth the guidelines for the purchase and sale of certain financial instruments and certain physical products, collectively defined as hedge instruments. The essential goal of the Energy Price Risk Management Policy is to provide a framework for the operation of a fuel and energy price hedging program to better manage CPS Energy's risk exposures in order to stabilize pricing and costs for the benefit of CPS Energy and its customers.

The hedge instruments are reported at cost on the Balance Sheet. Gains and losses related to the hedge instrument transactions are netted to fuel expense in the period realized. For FY 2007 and FY 2006, the commodity options and/or hedge instruments offset one another to achieve unrealized gains (losses) of approximately (\$892.8) thousand and \$240.4 thousand, respectively.

CPS Energy follows GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*.

Accordingly, the following information is provided regarding CPS Energy's outstanding financial hedge instruments as of January 31, 2007 and 2006:

Fuel Derivative Transactions as of January 31, 2007

Type of Transaction		Duration	Volumes in MMBtu
Long	Call	Dec 2007 through Mar 2008	6,310,000
Short	Call	Dec 2007 through Mar 2008	6,310,000
Short	Put	Dec 2007 through Mar 2008	6,310,000
Long	NG Futures	Mar 2007	50,000
Long	Basis Swap	Feb 2007 through Mar 2007	147,500

Fuel Derivative Transactions as of January 31, 2006

Type of Transaction		Duration	Volumes in MMBtu
Long	Call	Mar 2006 through Mar 2007	16,050,000
Short	Call	Mar 2006 through Mar 2007	16,580,000
Long	Put	Mar 2006 through Oct 2006	1,080,000
Short	Put	Mar 2006 through Mar 2007	16,050,000
Long	NG Futures	Mar 2006 through Oct 2006	530,000

The fair value of option contracts is determined using New York Mercantile Exchange ("NYMEX") closing settlement prices as of the last day of the reporting period. For futures and basis swap contracts, the fair value is calculated by deriving the difference between the closing futures prices on the last day of the reporting period and the futures or basis swap purchase prices at the time the positions were established, less applicable commissions. As of January 31, 2007, the total cost of the outstanding hedge instruments was \$30.7 thousand, with a fair value of (\$855.4) thousand. On January 31, 2006, total cost for outstanding hedge instruments was \$28.0 thousand, with a fair value of \$285.9 thousand.

In the event purchased options are allowed to expire, the related premiums paid to acquire those options will be lost. When a short position is established and options are sold, premiums are received and an obligation to honor the terms of the option contract, if exercised, is created. The decision to exercise the options or let them expire rests with the purchasing party.

Futures contracts represent a firm obligation to buy or sell the underlying asset. If held to expiration, the contract holder must take delivery of, or deliver, the underlying asset at the established contract price. Basis swap contracts represent a financial obligation to buy or sell the underlying delivery point basis. If held to expiration, the financial difference determined by mark-to-market valuation must be settled on a cash basis. Only if expressly requested in advance, may an exchange for physical assets take place.

The hedging contracts expose CPS Energy to a minimal amount of credit risk. In the event of default or nonperformance by brokers or NYMEX, the operations of CPS Energy could be materially affected. However, CPS Energy does not expect the brokerages to fail to meet their obligations given their high credit rating and the strict and deep credit requirements upheld by NYMEX, of which these brokerage houses are members. Termination risk for exchange-traded instruments is greatly reduced by the strict rules and guidelines established by NYMEX, which is governed by the Commodity Futures Trade Commission.

Securities Lending – CPS Energy, the 28% Decommissioning Trust and the 12% Decommissioning Trust began engaging in securities lending transactions in FY 2007 under a contract with their lending agent, Frost National Bank. Authority to engage in these transactions is granted under each entity's Investment Policy. Prior to January 31, 2007, the entities were authorized to loan up to 75.0% of their investments in securities lending transactions. The Investment Policies were revised effective January 31, 2007, authorizing up to 100.0% of investments to be loaned.

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending transactions. This guidance includes reporting certain securities lending collateral on the Balance Sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

In securities lending transactions, CPS Energy and the Decommissioning Trusts, through their lending agent, transfer securities to brokers/dealers in exchange for collateral and simultaneously agree to return the collateral for the same securities in the future. Cash collateral received from the borrower is invested in AAA-rated money market mutual funds. The maturities of these investments do not necessarily match the term of the loans, rather the investments are managed to maintain an average maturity of 30 days.

Lending income is earned if the returns on the cash collateral invested exceed the rebate paid to borrowers of the securities. The income is then shared with the lending agent to cover its fees based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from CPS Energy's or the Decommissioning Trusts' resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a loan premium for the securities loaned. This income is split at the same ratio as the earnings for cash collateral. The collateral pledged to CPS Energy or the Decommissioning Trusts for the loaned securities is held by the lending agent. These securities are not available to the Company or the Decommissioning Trusts for selling or pledging unless the borrower is in default of the loan.

Any collateral received is required to have a fair value of 102.0% of the loaned securities. Securities are marked to market daily, and additional cash or securities are required from the borrower if the market value of the collateral falls below 100.0%. Cash collateral is reported on the Balance Sheet as an asset, with a corresponding liability for the obligation. Noncash collateral for securities lending activities is not recorded as an asset because it remains under the control of the transferor, except in the event of default.

In the event of default, where the borrower is unable to return the securities loaned, CPS Energy and the Trusts have authorized the lending agent to seize the collateral held. The collateral would then be used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities may not be able to be replaced. The lending agent has indemnified CPS Energy and the Decommissioning Trusts from any loss due to borrower default in the event the collateral is not sufficient to replace the securities.

At year-end, neither CPS Energy nor the Decommissioning Trusts had any credit risk exposure to borrowers because the amounts the Company and/or the Trusts owed to borrowers exceeded the amounts the borrowers owed. There were no violations of legal or contractual provisions nor were there any borrower or lending agent default losses.

CPS Energy Direct Investments

At January 31, 2007, there was a total of \$779.6 million in securities, or 65.5% of the Company's direct investments, out on loan to brokers/dealers. In exchange, the Company received \$626.4 million in cash collateral and \$165.9 million in securities collateral, or 101.6% of the market value of the corresponding securities loaned. Income generated from securities lending transactions amounted to \$294.8 thousand in FY 2007, of which 30% was paid as fees to the lending agent totaling \$88.4 thousand.

Decommissioning Trusts

For the 28% Decommissioning Trust at December 31, 2006, there was a total of \$75.6 million in securities, or 29.7% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$75.2 million in cash collateral and \$2.8 million in securities collateral, or a total of 103.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$58.4 thousand in calendar year 2006, of which 30% was paid as fees to the lending agent totaling \$17.5 thousand.

For the 12% Decommissioning Trust at December 31, 2006, there was a total of \$36.2 million in securities, or 44.0% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Decommissioning Trust received \$34.8 million in cash collateral and \$2.5 million in securities collateral, or a total of 103.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$15.9 thousand in calendar year 2006, of which 30% was paid as fees to the lending agent totaling \$4.7 thousand.

12. Lease/Leaseback

In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon involving CPS Energy's Spruce 1 coal-fired electric generation unit. The transaction included a lease for a term of approximately 65 years in combination with a leaseback of the facility by CPS Energy for approximately 33 years.

CPS Energy retains fee simple title to, and operating control of, the facility and retains all revenues generated from sales of electricity produced from the facility. CPS Energy received the appraised fair value of the unit, \$725.0 million. This amount was recorded as deferred revenue, net of transaction expenses, and is being amortized over 381 months. The leaseback costs of \$628.3 million were recorded as prepaid items in 2001 and are being amortized over 381 months.

CPS Energy has the option to cancel the lease after it expires by making a payment to Exelon's affiliate. CPS Energy entered into a collateralized payment-undertaking agreement that will generate amounts sufficient to fund the cancellation option.

CPS Energy's net benefits associated with the transaction were approximately \$88.0 million. The City was paid \$12.3 million in accordance with the provisions of the New Series Bond Ordinance that permit 14% of this net benefit to be distributed. That distribution was recorded as a prepayment in the fiscal year ended January 31, 2001 and is being amortized over 381 months, or approximately 32 years. As a result, net proceeds from the transaction of approximately \$75.7 million are being reported over the 32-year leaseback term. In both FY 2007 and FY 2006, the net amount recorded as income by CPS Energy was \$2.8 million for each period.

13. South Texas Project

CPS Energy is one of three participants in STP, a two-unit nuclear power plant with Unit 1 nominally rated to produce 1,354.25 megawatts and Unit 2 nominally rated to produce 1,281.25 megawatts. The units, along with their support facilities and administrative offices, are located on a 12,220-acre site in Matagorda County, Texas. In-service dates for STP were August 1988 for Unit 1 and June 1989 for Unit 2. The other participants in STP are NRG Energy, Inc. and the City of Austin. Increased by the additional 12% interest acquired in FY 2006, CPS Energy's 40% ownership in STP represents 1,054.2 megawatts of total plant capacity. On February 2, 2006, NRG Energy, Inc. acquired one of the prior participants of STP, Texas Genco. See Note 4 – Capital Assets, Net for more information about CPS Energy's capital investment in STP.

New Units – On June 28, 2006, NRG Energy, Inc. announced plans to construct two additional reactors at the currently functioning STP site. With this addition, energy production is expected to increase by 2,700 megawatts for a total STP production capacity of 5,335.5 megawatts. NRG Energy, Inc. filed a letter of intent with the Nuclear Regulatory Commission ("NRC") on June 19, 2006, and will proceed with the permitting and development of the new units. CPS Energy, as co-owner, has an option to also participate in this new construction project and is currently conducting its own feasibility study to determine which course of action is in the best long-term interest of its customers. The costs associated with the feasibility study will be accumulated in a deferred account during the evaluation process. As of January 31, 2007, \$765.5 thousand have been spent on the feasibility study.

Effective November 17, 1997, the Participation Agreement among the owners of STP was amended and restated. At that time, the STP Nuclear Operating Company ("STPNOC"), a Texas nonprofit, nonmember corporation created by the participants, assumed responsibility as the licensed operator of STP. As of January 31, 2007, the agreement had not been amended. The participants share costs in proportion to ownership interests, including all liabilities and expenses of STPNOC.

CPS Energy amortizes its share of nuclear fuel for STP to fuel expense on a units-of-production method. Under the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the permanent disposal of spent nuclear fuel. CPS Energy is charged a fee for disposal of spent nuclear fuel, which is based upon CPS Energy's share of STP generation that is available for sale to CPS Energy customers. This charge is included in fuel expense monthly.

Nuclear Insurance – The Price-Anderson Act is a comprehensive statutory arrangement for providing limitations on liability and governmental indemnities with respect to nuclear accidents or events. The maximum amount that each licensee may be assessed following a nuclear incident at any insured facility is \$100.6 million, subject to adjustment for inflation, for the number of operating nuclear units and for each licensed reactor, payable at \$10.0 million per year per reactor for each nuclear incident. CPS Energy and each of the other participants of STP are subject to such assessments, which will be borne on the basis of their respective ownership interests. For purposes of these assessments, STP has two licensed reactors. The participants have purchased the maximum limits of nuclear liability insurance, as required by law, and have executed indemnification agreements with the NRC in accordance with the financial protection requirements of the Price-Anderson Act. A Master Worker Nuclear Liability policy, with a maximum limit of \$300.0 million for the nuclear industry as a whole, provides protection from nuclear-related claims.

NRC regulations require licensees of nuclear power plants to obtain on-site property damage insurance in a minimum amount of approximately \$1.1 billion. NRC regulations also require that the proceeds from this insurance be used first to ensure that the licensed reactor is in a safe and stable condition so as to prevent any significant risk to the public health or safety, and then to complete any decontamination operations that may be ordered by the NRC. Any funds remaining would then be available for covering direct losses to property.

The owners of STP currently maintain approximately \$2.8 billion of nuclear property insurance, which is above the legally required amount of \$1.1 billion, but is less than the total amount available for such losses. The \$2.8 billion of nuclear property insurance consists of \$500.0 million in primary property damage insurance and approximately \$2.3 billion of excess property damage insurance, both subject to a retrospective assessment being paid by all members of Nuclear Electric Insurance Limited ("NEIL"). A retrospective assessment could occur if property losses, as a result of an accident at any nuclear plant insured by NEIL, exceed the accumulated funds available to NEIL. The maximum aggregate assessment under current policies for both primary and excess property damage insurance is \$25.5 million during any one policy year.

Nuclear Decommissioning – CPS Energy, together with the other owners of STP, files a certificate of financial assurance with the NRC for the decommissioning of the nuclear power plant. The certificate assures that CPS Energy and the other owners meet the minimum decommissioning funding requirements mandated by the NRC.

The STP owners agreed in the financial assurance plan that their estimate of decommissioning costs would be reviewed and updated periodically. In 1999, the owners conducted a review of decommissioning costs. The results estimated CPS Energy's share of decommissioning costs at approximately \$311.0 million in 1998 dollars. In 2004, the owners conducted an additional review of decommissioning, and results showed that CPS Energy's share of decommissioning costs was approximately \$397.4 million in 2004 dollars. Although there was an increase in decommissioning base costs from the 1998 study to the 2004 study, there was an offsetting decrease in applicable cost escalation assumptions. Therefore, CPS Energy was able to decrease its minimum annual contribution requirement from \$15.9 million in FY 2004 to \$6.9 million in FY 2005, which included the partial-year effect of the updated study. Reflecting a full year's impact of the most recent study, CPS Energy's minimum annual contribution requirement was \$5.0 million in FY 2006 and remained at \$5.0 million for FY 2007.

In 1991, CPS Energy started accumulating the decommissioning funds for the 28% portion in an external trust in accordance with the NRC regulations. The 28% Decommissioning Trust's assets and related liabilities are included in CPS Energy's financial statements as a component unit. Excluding securities lending cash collateral, as of December 31, 2006 and 2005, CPS Energy had accumulated approximately \$256.2 million and \$231.6 million, respectively, in that 28% external trust. Based on the most recent annual calculation of financial assurance required by the NRC, CPS Energy's 28% Decommissioning Trust balance exceeded the calculated financial assurance amounts of \$87.3 million at December 31, 2006, and \$76.7 million at December 31, 2005.

In conjunction with the acquisition of the additional 12% interest in STP in May 2005, CPS Energy also assumed control of a relative portion of the decommissioning trust previously established by the prior owner, AEP. This is referred to as the 12% Decommissioning Trust, and its assets and related liabilities are also included in CPS Energy's financial statements as a component unit.

Subject to PUCT approval as requested in the future, credits or deficiencies in the funding of this trust will be received from or distributed to AEP customers. Excluding securities lending cash collateral, as of December 31, 2006 and 2005, that trust had accumulated approximately \$82.7 million and \$70.1 million, respectively. According to the 2004 study mentioned above, the estimated decommissioning costs for that trust are approximately \$170.3 million in 2004 dollars. Based on the most recent annual calculation of financial assurance required by the NRC, the 12% Decommissioning Trust balance exceeded the calculated financial assurance amount of \$37.4 million at December 31, 2006, and \$32.9 million at December 31, 2005.

Both Decommissioning Trusts also have separate calendar-year financial statements. These separately audited financial statements can be obtained by contacting the Controller at CPS Energy.

STP Pension Plan and Other Postretirement Benefits – STP maintains a noncontributory defined-benefit pension plan covering most employees. Retirement benefits are based on length of service and compensation. Plan assets are invested in various equity and fixed-income securities. No company contributions were made during the 2005 calendar year. Pension contributions in the amount of \$9.9 million were made by STP in the 2006 calendar year, of which \$7.9 million were for the 2005 plan year. Included in the STP pension liability for calendar years 2006 and 2005 is an additional minimum pension liability, which has been recognized as required due to the Plan's funding status, of \$18.8 million and \$15.1 million, respectively.

Employees whose pension benefits exceed \$220.0 thousand for Employee Retirement Income Security Act limitations are covered by a supplementary nonqualified, unfunded pension plan, which is provided for by charges to operations sufficient to meet the projected benefit obligation. The accruals for the cost of that plan are based on substantially the same actuarial methods and economics as the noncontributory defined-benefit pension plan.

STP also maintains a defined-benefit postretirement plan that provides medical, dental and life insurance benefits for substantially all retirees and eligible dependents. The cost of these benefits is recognized in the project statements during an employee's active working career. STP has a trust to partially meet the obligations of the plan.

The owners of STP, including CPS Energy, share in all plan costs in the same proportion as their respective ownership percentages.

STP Pension Plan
Schedule of Funding Status (RSI – Unaudited)
Calendar Years 2006 and 2005
(In thousands)

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Change in benefit obligation				
Benefit obligation – beginning	\$ 153,187	\$ 131,159	\$ 58,866	\$ 58,770
Service cost	7,498	6,164	4,332	3,973
Interest cost	9,101	7,813	3,299	3,048
Amendments	8,454	-	(2,884)	(13,470)
Actuarial loss	2,021	9,972	(8,194)	9,021
Benefits paid	(2,061)	(1,921)	(2,233)	(2,476)
Benefit obligation – ending	178,200	153,187	53,186	58,866
Change in plan assets				
Fair value of plan assets – beginning	100,808	89,989	9,975	9,752
Actual return on plan assets	9,070	12,740	451	790
Employer contributions	9,869	-	2,233	1,909
Benefits paid	(2,061)	(1,921)	(2,233)	(2,476)
Fair value of plan assets – ending	117,686	100,808	10,426	9,975
Funded status – ending	(60,514)	(52,379)	(42,760)	(48,891)
Unrecognized net actuarial loss	32,954	32,994	23,419	33,426
Unrecognized prior service cost	10,557	3,053	(16,656)	(14,958)
Unrecognized transition obligation	-	-	431	486
Net amount recognized	(17,003)	(16,332)	(35,566)	(29,937)
Additional minimum pension liability	(18,839)	(15,098)	-	-
Accrued benefit cost	\$ (35,842)	\$ (31,430)	\$ (35,566)	\$ (29,937)
Weighted-average assumptions				
Discount rate	5.75%	5.75%	5.80%	5.75%
Expected return on plan assets	8.50%	8.50%	8.50%	8.50%
Rate of compensation increase	3.00%	3.00%	3.00%	3.00%

14. Lignite Mining Lease and Assignment Agreement

CPS Energy entered into a lignite mining lease with Aluminum Company of America ("Alcoa") effective December 28, 1998, covering all of CPS Energy's lignite reserves in Bastrop and Lee Counties of Texas. Alcoa began making advance royalty payments to CPS Energy under the lease in January 1999. This converted to a production royalty when mining began in July 2005. All advance royalties previously received by CPS Energy are being deducted from production royalties at the same rate at which they were paid. The CPS Energy royalty falls within industry standard terms and is based on production volumes subject to certain minimum annual amounts. The base term of the lease runs through 2013. Renewal and extension options could result in Alcoa extending the lease to 2043.

On April 13, 2007 CPS Energy signed a Purchase and Sale Contract with a third party for the sale of the lignite properties.

15. Joint Operations Agreement

A 1997 Joint Operations Agreement ("JOA") resulted from the litigation settlement with a predecessor of Texas Genco II, L.P. ("Texas Genco") over its management of STP during the construction and early operating periods. The JOA was an arrangement to jointly dispatch CPS Energy's and Texas Genco's generating plants—other than STP—to take advantage of the most efficient plants and favorable fuel prices of each utility. Until June 2002, CPS Energy received 90.0% of the savings realized from the jointly operated systems in monthly cash payments. As of June 2002, when Texas Genco met the JOA \$200.0 million cumulative savings obligation, monthly cash payments to CPS Energy were reduced to 50.0% of the savings realized. As of January 24, 2006, CPS Energy's total cumulative payments from savings realized were \$310.4 million. Due to changes in market conditions and the ERCOT market structure, Texas Genco terminated the agreement as of January 24, 2006. On January 25, 2006, CPS Energy began directly representing its generation and load in the Texas energy market place.

16. Commitments and Contingencies

Purchase and construction commitments approximated \$2.3 billion at January 31, 2007. This amount includes provisions for natural gas purchases expected through June 2010; the actual amount to be paid will depend upon CPS Energy's actual requirements during the contract period and the price of gas. Also included are provisions for coal purchases through December 2021 and for coal transportation through December 2014.

CPS Energy also has other purchase commitments totaling \$1.6 billion. This amount includes provisions for wind power through December 2027, landfill power through December 2020, capacity and other power purchases through December 2009, and raw uranium associated with STP fabrication and conversion services needed for refueling through May 2026.

The PUCT promulgated new rules in 1996 designed to comply with legislative changes affecting the utility industry. The Transmission Pricing and Access Rule mandates that electric utilities charge customers for wholesale open transmission access according to a formula based on the amount of load served by each utility. Reported costs are based on payments to other transmission providers, less receipts for wholesale transmission services that CPS Energy provided. CPS Energy's cost for calendar years 2006 and 2005 was approximately \$18.5 million and \$15.1 million, respectively. CPS Energy has not calculated its cost for calendar year 2007.

In the fiscal year ended January 31, 2003, CPS Energy entered into a 20-year agreement with Brooks Development Authority ("BDA") to upgrade the electric and gas utility systems located within the Brooks City-Base. CPS Energy and BDA have each committed to invest \$6.3 million (\$4.2 million in year 2002 dollars, which accumulates interest at the rate of 3.7% compounded annually) to upgrade the infrastructure at that location. Annual reductions to BDA's obligation are made from incremental revenues to the City for electric and gas sales made to customers that reside on the BDA-developed property. Annual reductions to BDA's obligation are also made in accordance with contract terms for economic development at the Brooks City-Base that benefits CPS Energy's electric and gas systems. BDA's obligation is backed by the City.

To the extent that the capital renewals and upgrades do not total \$12.6 million by September 2022, BDA's and CPS Energy's obligations each will be reduced equally. To date, CPS Energy has invested \$3.7 million and BDA has reduced its obligation, net of annual interest, by \$0.8 million.

The Tax Increase Prevention and Reconciliation Act of 2005 enacted on May 17, 2006, added section 4965 to the Code ("Section 4965"), which imposes an excise tax with respect to "prohibited tax shelter transactions" on certain "tax-exempt entities," including a state or political subdivision thereof, such as

the City. CPS Energy, acting for the benefit of the City, entered into a series of leasing transactions in 2000, which may be considered prohibited tax shelter transactions.

Although the scope and applicability of Section 4965 is not clear, under one possible reading the IRS could assert that CPS Energy would be subject to the excise tax on a basis similar to a taxable entity. Accordingly, the City could be liable for an excise tax at the highest corporate tax rate (currently 35.0%) upon the greater of its net income for the taxable year properly attributable to the leasing transactions or 75.0% of the proceeds received by the City for the taxable year attributable to the leasing transactions. There are also additional excise tax provisions relating to "entity managers" (generally, persons with responsibility within the tax-exempt entity) and for certain "knowing" transactions, in which the tax-exempt entity knew or had reason to know that it was entering into a prohibited tax shelter transaction. In general, the new excise tax is effective for taxable years ending after the date of enactment of Section 4965.

CPS Energy has not been able to definitively determine the amount, if any, of the potential excise taxes it would be responsible for under Section 4965. However, the excise taxes under one scenario could exceed \$12.0 million for the taxable year ending in 2007. CPS Energy has not attempted to make any calculations for later taxable years. It is possible under some interpretations of Section 4965 that CPS Energy would not owe any excise taxes with respect to the leasing transactions.

In the normal course of business, CPS Energy is involved in legal proceedings related to alleged personal and property damages, breach of contract, condemnation appeals and discrimination cases. In addition, CPS Energy's power generation activities and other utility operations are subject to extensive state and federal environmental regulation. In the opinion of CPS Energy's management, the outcome of such proceedings will not have a material adverse effect on the financial position or results of operations of CPS Energy.

GLOSSARY OF TERMS

Advance Refunding: A bond issuance in which new bonds are sold at a lower interest rate than outstanding ones. The proceeds are then invested in an irrevocable escrow; and when the older bonds become callable, they are paid off with the invested proceeds.

Allowance for Funds Used During Construction ("AFUDC"): A cost accounting procedure whereby interest, charges on borrowed funds and a return on equity capital used to finance construction are added to utility plant being constructed (i.e., capitalized interest).

Amortize: To reduce an original amount or an account balance on an installment basis. Depreciation is a specific type of amortization.

Assets: Resources of value to the firm to which it has exclusive rights of use.

Balance Sheet: A statement of financial position as of a specific date, listing assets, liabilities and owner's equity.

Call: An option contract giving the owner the right (but not the obligation) to buy a specified amount of an underlying security at a specified price within a specified time.

Capital ("capital assets"): An asset with a life of more than one year that is not bought and sold in the ordinary course of business.

Cash and Cash Equivalents: The value of assets that can be converted into cash immediately. Usually includes bank accounts and marketable securities, such as government bonds. Cash equivalents on Balance Sheets include securities (e.g., notes) with an original maturity of 90 days or less.

Community Infrastructure and Economic Development ("CIED"): CIED funds are used to support qualified capital projects that provide economic benefit within the communities served by CPS Energy.

Component Unit: A legally separate entity for which the elected officials of the primary government are financially accountable and for which the nature and significance of its relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Cooling-Degree Day: This measures how high the average daily temperature is relative to a reference temperature of 72 degrees Fahrenheit. Example: If the average temperature for the day is 78 degrees, then the Cooling-Degree Days are equal to six.

Decommissioning: The process related to permanently taking a nuclear plant out of service, including decontaminating and removing buildings or other structures. Cleanup is concerned with ground remediation of contaminated land.

Defeasance: A provision that legally discharges a borrower for debt incurred when the borrower sets aside cash or bonds sufficient to service the debt outstanding.

Depletion: The systematic allocation of the cost of a natural resource from the balance sheet to the income statement.

Depreciation: Amount allocated during the period to expense the cost of acquiring long-term assets over the useful life of the assets.

Derivative: In finance, a security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Examples of derivatives include futures and options.

Electric Reliability Council of Texas ("ERCOT"): An organization whose mission is to direct and ensure reliable and cost-effective operation of the electric transmission grid in Texas and to enable fair and efficient market-driven solutions to meet customers' electric service needs.

Fair Market Value: The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federal Energy Regulatory Commission ("FERC"): Independent federal agency created within the U.S. Department of Energy. FERC is vested with broad regulatory authority over wholesale electric, natural gas and oil production and the licensing of hydroelectric facilities.

Fiscal Year ("FY"): The 12-month period covered by the income statement. A fiscal year may or may not coincide with a calendar year. For CPS Energy, the fiscal year is from February 1 through January 31. Accordingly, the quarter-ends are April 30, July 31, October 31 and January 31.

Futures: A financial contract obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange.

Governmental Accounting Standards Board ("GASB"): The authoritative standard-setting body for accounting and financial reporting for governmental entities in the United States.

Heating-Degree Day: This measures how low the average daily temperature is relative to a reference temperature of 65 degrees Fahrenheit. Example: If the average temperature for the day is 60 degrees, then the Heating-Degree Days are equal to 5.

Hedging: The process of buying and selling fuel oil, natural gas, and electric energy futures, options or similar contracts to protect against loss due to price fluctuations.

Kilowatt ("kW"): A measure of electric power. A kilowatt equals 1,000 watts. It produces enough energy to light up ten 100-watt light bulbs.

Kilowatt-hour ("kWh"): A measure of electric power. A kilowatt hour equals 1,000 watts of energy flowing for a one-hour period.

Lease: A legal agreement to pay rent to the lessor for a stated period of time. Sometimes the lease is in substance a purchase of an asset and a financing arrangement, i.e., capital lease.

Lease/Leaseback: A financing transaction that involves a company leasing an asset to another entity and that entity subleasing the asset back to the company.

Liabilities: Claims by creditors against the assets of the firm.

MCF: 1,000 cubic feet. Measures natural gas volumes.

MMBtu: 1,000,000 British Thermal Units ("BTU"). A BTU is the standard unit for measuring the quantity of heat energy, such as the heat content of fuel. It is the amount of heat energy necessary to raise the temperature of one pound of water one degree Fahrenheit at sea level pressure.

Management's Discussion & Analysis ("MD&A"): A section of the annual report that contains objective and easily readable analysis from management about the company's financial condition and its operations to assist users in assessing the company's financial position.

Megawatt ("MW"): A measure of electric power. A megawatt equals 1,000 kilowatts or 1,000,000 watts.

Megawatt-hour ("MWh"): Basic electric energy unit equal to one megawatt of power flowing for one hour.

National Association of Regulatory Utility Commissioners ("NARUC"): A nonprofit organization whose members include the governmental agencies that are engaged in the regulation of utilities and carriers in the 50 United States, the District of Columbia, Puerto Rico and the Virgin Islands. NARUC's member agencies regulate the activities of telecommunications, energy, and water utilities.

New Series Bonds: A CPS Energy term used to distinguish bonds that have a first lien on the net revenues of CPS Energy's systems.

Public Utility Commission of Texas ("PUCT"): The governmental commission that regulates the rates and services of telephone utilities; investor-owned electric, water and sewer utilities; electric, water and sewer utilities in unincorporated areas; and radio companies statewide. The PUCT does not have authority to regulate retail activities of municipally owned utilities.

Put: An option contract giving the owner the right (but not the obligation) to sell a specified amount of an underlying asset at a set price within a specified time.

Qualified Scheduling Entity ("QSE"): Entities that are qualified by ERCOT to submit balanced schedules, bid for ancillary services and settle payments. QSEs submit schedules on behalf of resource entities such as energy generators or load-serving entities such as retail electric providers.

Refunding: Retiring an outstanding bond issue after the first call date by using money from the sale of a new offering.

Required Supplementary Information (RSI): Schedules, statistical data and other information that are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity.

Revenue Bonds: Bonds issued by a municipality in which the issuer pledges to the bondholders its revenues as security for the bonds.

Securities Lending: An investment strategy that involves the temporary loan of securities to another party, typically dealers. For the full time that the securities are out on loan, they are secured with cash collateral in excess of the value of the securities that are lent, and in return for the use of securities, the lender earns a spread on the cash pledged as collateral.

South Texas Project ("STP"): A two-unit nuclear plant and is one of the newest and largest nuclear power plants in the country. STP's two reactors have a capacity of 2,562.5 megawatts of electricity, enough to provide service for more than one million homes and businesses in South Central Texas.

Tax-Exempt Bond: A bond usually issued by municipal, county, or state government whose interest payments are not subject to the bondholders' federal income tax and, in some cases, state and local income tax.

Tax-Exempt Commercial Paper ("TECP"): A short-term note with a maximum maturity of 270 days whose interest payments are not subject to the bondholders' federal income tax and, in some cases, state and local income tax. Maturities for TECP notes, however, can be extended indefinitely for the life of the program that supports the TECP notes.

Transmission Costs of Service ("TCOS"): A functional classification of expenses and capital expenditures relating to the operation and maintenance of the transmission plant. The transmission function is that portion of the utility system used for the purpose of transmitting electrical energy in bulk to other principal parts of the system or to other utility systems.

Variable Rate Demand Obligation ("VRDO"): A long-term bond with a floating interest rate that varies as it is re-determined periodically (daily, weekly, semi-annually, annually, etc.).

APPENDIX C



CPS ENERGY

CERTAIN PROVISIONS OF THE ORDINANCE

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CERTAIN PROVISIONS OF THE ORDINANCE

The following constitutes a summary of certain selected provisions of the Ordinance. This summary should be qualified by reference to other provisions of the Ordinance referred to elsewhere in this Official Statement, and all references and summaries pertaining to the Ordinance in this Official Statement are, separately and in whole, qualified by reference to the exact terms of the Ordinance, a copy of which may be obtained from the City.

SECTION 1.1. *Definitions.*

For all purposes of this Ordinance, except as otherwise expressly provided or unless the context otherwise requires, (a) the terms defined in this Section have the meanings assigned to them in this Section, certain terms defined in other sections of and the preamble to this Ordinance have the meanings assigned to them in such sections and preamble, and all such terms include the plural as well as the singular; (b) all references in this Ordinance to designated "**Sections**," "**Schedules**," "**Exhibits**," and other subdivisions are to the designated Sections, Schedules, Exhibits, and other subdivisions of this Ordinance as originally adopted; and (c) the words "**herein**," "**hereof**," and "**hereunder**" and other words of similar import refer to this Ordinance as a whole and not to any particular Section or other subdivision.

"**AA' Composite Commercial Paper Rate**" on any date of determination means (1) the interest equivalent of the 30-day rate on financial commercial paper placed on behalf of issuers whose corporate bonds are rated "AA" by S&P, or the equivalent of such rating by Moody's or Fitch as made available on a discount basis or otherwise by the Federal Reserve Bank for "AA" financial commercial paper on its World Wide Web site for the Market Day immediately preceding such date of determination, or (2) if the Federal Reserve Bank does not make available any such rate, then the arithmetic average of the interest equivalent of the 30-day rate on financial commercial paper, as quoted on a discount basis or otherwise by the Commercial Paper Dealers to the Auction Agent for the close of business on the Market Day immediately preceding such date of determination; *provided* that if any Commercial Paper Dealer does not quote a financial commercial paper rate required to determine the "AA" Composite Commercial Paper Rate, the "AA" Composite Commercial Paper Rate shall be determined on the basis of such quotation or quotations furnished by the remaining Commercial Paper Dealer or Commercial Paper Dealers and any Substitute Commercial Paper Dealer or Substitute Commercial Paper Dealer selected by a Market Agent at the request of the City to provide such quotation or quotations not being supplied by any Commercial Paper Dealer or Commercial Paper Dealers, as the case may be, or if a Market Agent does not select any such Substitute Commercial Paper Dealer or Substitute Commercial Paper Dealers, by the remaining Commercial Paper Dealer or Commercial Paper Dealers. For purposes of this definition, the "**interest equivalent**" of a rate stated on a discount basis (referred to in this definition as a "**discount rate**") for commercial paper of a given day's maturity shall be equal to the product of (a) 100 and (b) the quotient (rounded upwards to the next higher one thousandth (.001) of 1%) of (i) the discount rate (expressed in decimals) divided by (ii) the difference between (x) 1.00 and (y) a fraction, the numerator of which shall be the product of the discount rate (expressed in decimals) times the number of days in which such commercial paper matures and the denominator of which shall be 360.

"**Accountant**" means a certified public accountant or accountants or a firm of certified public accountants, in either case with demonstrated experience and competence in public accountancy.

"**Acts**" has the meaning stated in the preamble to this Ordinance.

"**Additional Junior Lien Obligations**" means (1) any bonds, notes, warrants, certificates of obligation, or other Debt hereafter issued by the City that are payable, in whole or in part, from and equally and ratably secured by a lien on and pledge of the Net Revenues that is junior and inferior to the lien on and pledge of the Net Revenues that have or will be granted as security for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City, but prior and superior to the lien on and pledge of the Net Revenues that have or will be granted as security for the Commercial Paper Obligations and any Inferior Lien Obligations hereafter issued by the City and (2) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or in part, by such a junior and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

"**Additional Senior Lien Obligations**" means (1) any bonds, notes, warrants, certificates of obligation, or other evidences of indebtedness which the City reserves the right to issue or enter into, as the case may be, in the future under the terms and conditions provided in *Section 6.2* and which are equally and ratably secured solely by a prior and first lien on and pledge of the Net Revenues of the Systems and (2) any obligations hereafter issued to refund any of the foregoing if

issued in a manner so as to be payable from and secured by a prior and first lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

“Adjusted Auction Rate” means the Auction Rate plus the Service Charge Rate.

“Applicable Factor” means for (1) each Interest Period for Bonds in an Auction Mode immediately preceded by an Auction Date, the excess of (a) the Adjusted Auction Rate for such Bonds in such Interest Period over (b) the Service Charge Rate for such Interest Period and (2) each Interest Period for Bonds in an Auction Mode not immediately preceded by an Auction Date, the Adjusted Auction Rate for such Bonds in such Interest Period.

“Applicable Percentage” on any date of determination means the percentage determined as set forth below (as such percentage may be adjusted pursuant to *Section 2.3G(1)*) based on the Prevailing Rating of the Bonds while in an Auction Mode in effect at the close of business on the Market Day immediately preceding such date of determination:

<u>Prevailing Rating</u>	<u>Applicable Percentage</u>
“AAA”	175%
“AA”	200
“A”	250
“BBB”	275
Below “BBB”	300

“Auction” means each periodic implementation of the Auction Procedures.

“Auction Agent” means the person appointed by the City to act as Auction Agent for the Bonds in an Auction Mode in accordance with *Section 2.2H* until a substitute Auction Agent becomes such pursuant to such Section, and thereafter ***“Auction Agent”*** shall mean such successor.

“Approval Certificate” means a written instrument executed by a Designated Financial Officer in accordance with *Sections 2.1, 2.2C, or 2.5B*.

“Auction Agent Fee Rate” for any Interest Period in an Auction Mode means the rate per annum at which the fee to be paid to the Auction Agent for the services rendered by it under the Auction Agreement and the Broker-Dealer Agreements with respect to the Auction Date, if any, at the end of such Interest Period accrues.

“Auction Agreement” means any Auction Agent Agreement entered into by the Paying Agent/Registrar and the Auction Agent in accordance with *Section 2.2H*, as originally executed or as supplemented, modified, or amended from time to time.

“Auction Date” means the Market Day immediately preceding the first day of each Interest Period for Bonds in an Auction Mode, other than Interest Periods commencing:

- (1) after the Bonds are no longer Book-Entry Only Bonds;
- (2) after the occurrence and during the continuance of a Payment Default; or
- (3) less than two Market Days after the cure or waiver of a Payment Default,

on which dates no Auction shall occur.

“Auction Mode” for any Bond means the period of time, determined in accordance with *Sections 2.2B and 2.2C*, during which interest on such Bond accrues at the Adjusted Auction Rate therefor.

"Auction Procedures" means the procedures for conducting Auctions for the purchase or retention of Bonds specified in *Section 2.3*.

"Auction Rate" for Bonds in an Auction Mode, for the Interest Period immediately following an Auction Date, means the rate that the Auction Agent advises the Paying Agent/Registrar has resulted from implementation of the Auction Procedures on such Auction Date.

"Available Bonds" as of an Auction Date means the aggregate principal amount of Bonds in an Auction Mode with Interest Periods of applicable duration that are not subject to Submitted Hold Orders at the close of business on the immediately preceding Record Date for such Bonds.

"Available Money" means all amounts as to which the Paying Agent/Registrar and the Credit Enhancer have received an Opinion of Counsel stating that no disbursement thereof pursuant to this Ordinance may be avoided or otherwise recovered under Section 547 (or under Section 550 in respect of such Section) of the Bankruptcy Code or under any similar provision of state law in the event of the bankruptcy, insolvency, liquidation, reorganization, or similar proceeding in respect of the City.

"Bank Bond" as of any date means any Bond or portion thereof which has been purchased by the Liquidity Bank pursuant to *Section 2.6D(2)* on or before such date, if on or before such date and subsequent to such purchase (1) such Bond or portion has not been sold by the Holder thereof through the Remarketing Agent therefor against payment of the Purchase Price therefor and (2) the Bank Bondholder of such Bond or portion shall not have declined to sell such Bond or portion on demand of such Remarketing Agent in accordance with the provisions of the Liquidity Facility.

"Bank Bond Register" has the meaning stated in *Section 2.4*.

"Bank Bondholder" when used with respect to any Bank Bond means the Person in whose name such Bank Bond is registered in the Bank Bond Register.

"Bank Differential" when used with respect to any Bank Bond (or portion thereof) as of any date means the difference, if positive, obtained by subtracting (1) interest accrued thereon to such date from the most recent Interest Payment Date to which interest on such Bond (or portion) has been paid or duly provided for at the Daily Rate, Weekly Rate, Commercial Paper Rate, or Term Rate applicable thereto from time to time in effect to such date, determined as if such Bond (or portion) were not a Bank Bond and such interest were not compounded, from (2) all interest actually accrued on such Bank Bond (or portion) from such Interest Payment Date to such date.

"Bank Rate" means, for each day of accrual, (1) except as described in *Clause (2)* of this definition, the rate defined as such in the initial Liquidity Facility, or (2) any different rate defined as the "Bank Rate" in any alternate Liquidity Facility accepted by the Paying Agent/Registrar pursuant to *Section 4.1C*, if the Paying Agent/Registrar shall have received an Opinion of Counsel to the effect that the accrual of interest on Bank Bonds at such different rate is authorized under Texas law and will not adversely affect any excludability of interest on any Bond from the gross income of the owner thereof for federal income tax purposes.

"Bankruptcy Code" means Title 11, United States Code, as now or hereafter constituted.

"Bid" has the meaning specified in *Section 2.3A(1)*.

"Bidder" has the meaning stated in *Section 2.3A(1)*.

"Board" or **"Board of Trustees"** means the Board of Trustees of the Systems confirmed and described in *Section 6.11*.

"Bond Fund" shall mean the special Fund or account created and established by the provisions of *Section 5.2*.

"Bonds" means the CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003, authorized by this Ordinance.

"Book-Entry Only Bond" means any Bond registered in the name of the Securities Depository or its nominee.

"Broker-Dealer" for the Bonds in an Auction Mode means any broker or dealer (each as defined in the Securities Exchange Act of 1934, as amended), commercial bank, or other entity that is permitted by law to perform the function required of a Broker-Dealer by the Auction Procedures for the benefit of Existing Owners and Potential Owners of Bonds, is a member of (or a participant in) the Securities Depository, has been selected by the City with the approval of the Market Agent, and is a party to a Broker-Dealer Agreement with the Auction Agent that remains effective. Such selection of the City shall be evidenced by an ordinance or resolution enacted by the City Council or, if the Person selected to act as a Broker-Dealer for the Bonds is then the Remarketing Agent, may be evidenced by an Approval Certificate.

"Broker-Dealer Agreement" means each Broker-Dealer Agreement entered into between the Auction Agent and a Broker-Dealer with the approval of the City, as originally executed or as supplemented, modified, or amended from time to time.

"Broker-Dealer Fee Rate" for any Interest Period for the Bonds in an Auction Mode means the rate per annum at which the service charge to be paid to the Broker-Dealers for the services rendered by them with respect to the Auction Date, if any, at the end of such Interest Period accrues.

"Business Day" for the Bonds or portions thereof means any day other than (1) a Saturday or a Sunday, (2) a legal holiday or the equivalent on which banking institutions generally are authorized or required to close in the Place of Payment or in the city in which is located the corporate trust office of the Paying Agent/Registrar or, on or before the first day of the Fixed Mode (and except while an Auction Mode is in effect) for such Bonds or portions, the principal office of the Remarketing Agent or, while a Credit Facility is in effect, the office of the Credit Enhancer or of its agent at which drafts or demands for payment under the Credit Facility are to be presented or, while the Liquidity Facility is in effect, the office of any Liquidity Bank or of its agent at which drafts or demands for payment under the Liquidity Facility are to be presented, or (3) a day on which the New York Stock Exchange is closed.

"City" means the City of San Antonio, Texas, and, where appropriate, the City Council of the City.

"Closing Date" shall mean the date of physical delivery of the Initial Bonds against payment in full by the Purchaser.

"Code" means the Internal Revenue Code of 1986, as amended and in force and effect on the Closing Date.

"Commercial Paper Dealers" means such commercial paper dealer or dealers as the City may from time to time appoint or, in lieu of any thereof, their respective affiliates or successors.

"Commercial Paper Mode" for any Bond or portion thereof means any period of time, determined in accordance with Section 2.2C, during which interest on such Bond or portion (except when a Bank Bond) accrues at the Commercial Paper Rate therefor.

"Commercial Paper Obligations" means (1) the currently authorized obligations of the City from time to time outstanding and unpaid that are payable wholly or in part from a lien on and pledge of the Net Revenues that is subordinate and inferior to the pledge thereof securing payment of the currently outstanding Senior Lien Obligations and the Bonds and any Additional Senior Lien Obligations and Additional Junior Lien Obligations hereafter issued by the City, all as further provided in Section 6.2, identified as follows:

"City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A", originally authorized in the aggregate principal amount of \$450,000,000, including the Credit Agreement (as defined in the ordinance authorizing the issuance of the Commercial Paper Obligations); and

(2) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding obligations are payable from and equally and ratably secured, in whole or in part, by such a subordinate and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

"Commercial Paper Rate" for any Bond or portion thereof has the meaning stated in Section 2.2B, to be determined in accordance with Section 2.2E(4).

"Credit Agreement" means a loan agreement, revolving credit agreement, agreement establishing a line of credit, letter of credit, reimbursement agreement, insurance contract, commitments to purchase debt, purchase or sale agreements,

interest rate swap agreements, or commitments or other contracts or agreements authorized, recognized, and approved by the City as a Credit Agreement in connection with the authorization, issuance, security, or payment of any obligation authorized by Chapter 1371, as amended, Texas Government Code.

"Credit Enhancer" means the obligor on the Credit Facility, if any, most recently accepted by the Paying Agent/Registrar pursuant to *Section 4.2K* and such obligor's successors in such capacity and assigns.

"Credit Enhancer Default" means the occurrence and continuance of one or more of the following events: (1) wrongful dishonor of any demand or claim made under the Credit Facility; (2) the issuance, under the applicable laws of any state, of an order of rehabilitation, liquidation, or dissolution of the Credit Enhancer; (3) the commencement by the Credit Enhancer of a voluntary case or other proceeding seeking liquidation, reorganization, or other relief with respect to itself or its debts under any bankruptcy, insolvency, or other similar law now or hereafter in effect including, without limitation, the appointment of a Paying Agent/Registrar, receiver, liquidator, custodian, or other similar official for itself or any substantial part of its property; (4) the consent by the Credit Enhancer to any relief referred to in the preceding *Clause (3)* in an involuntary case or other proceeding commenced against it; (5) the making by the Credit Enhancer of an assignment for the benefit of creditors; (6) the failure of the Credit Enhancer generally to pay its debts or claims when due; or (7) the initiation by the Credit Enhancer of any action to authorize any of the foregoing.

"Credit Facility" means the obligation most recently accepted by the Paying Agent/Registrar pursuant to *Section 4.2K*, if any, including all endorsements, amendments, and extensions thereof.

"Daily Mode" for any Bond or portion thereof means any period of time, determined in accordance with *Section 2.2C*, during which interest on such Bond (except when a Bank Bond) accrues at the Daily Rate therefor.

"Daily Rate" has the meaning stated in *Section 2.2B*, to be determined in accordance with *Section 2.2E(1)*.

"Debt" means (1) all indebtedness payable from Net Revenues incurred or assumed by the City for borrowed money (including indebtedness payable from Net Revenues arising under Credit Agreements) and all other financing obligations of the Systems payable from Net Revenues that, in accordance with generally accepted accounting principles, are shown on the liability side of a balance sheet; and (2) all other indebtedness payable from Net Revenues (other than indebtedness otherwise treated as Debt hereunder) for borrowed money or for the acquisition, construction, or improvement of property or capitalized lease obligations pertaining to the Systems that is guaranteed, directly or indirectly, in any manner by the City, or that is in effect guaranteed, directly or indirectly, by the City through an agreement, contingent or otherwise, to purchase any such indebtedness or to advance or supply funds for the payment or purchase of any such indebtedness or to purchase property or services primarily for the purpose of enabling the debtor or seller to make payment of such indebtedness, or to assure the owner of the indebtedness against loss, or to supply funds to or in any other manner invest in the debtor (including any agreement to pay for property or services irrespective of whether or not such property is delivered or such services are rendered), or otherwise. For the purpose of determining Debt, there shall be excluded any particular Debt if, upon or prior to the maturity thereof, there shall have been deposited with the proper depository (a) in trust the necessary funds (or investments that will provide sufficient funds, if permitted by the instrument creating such Debt) for the payment, redemption, or satisfaction of such Debt or (b) evidence of such Debt deposited for cancellation; and thereafter it shall not be considered Debt. No item shall be considered Debt unless such item constitutes indebtedness under generally accepted accounting principles applied on a basis consistent with the financial statements of the Systems in prior Fiscal Years.

"Debt Service Requirements" means as of any particular date of computation, with respect to any obligations and with respect to any period, the aggregate of the amounts to be paid or set aside by the City as of such date or in such period for the payment of the principal of, premium, if any, and interest (to the extent not capitalized) on or other payments due under such obligation, assuming, in the case of obligations without a fixed numerical rate, that such obligations bear interest or other payment obligations calculated by assuming (1) that such non-fixed interest rate for every future 12-month period is equal to the rate of interest reported in the most recently published edition of The Bond Buyer (or its successor) at the time of calculation as the "Revenue Bond Index" or, if such Revenue Bond Index is no longer being maintained by The Bond Buyer (or its successor) at the time of calculation, such interest rate shall be assumed to be 80% of the most recently reported yield, as of the time of calculation, at which United States Treasury obligations of like maturity have been sold and (2) that, in the case of bonds not subject to fixed scheduled mandatory sinking fund redemptions, that the principal of such bonds is amortized such that annual debt service is substantially level over the remaining stated life of such bonds, and in the case of obligations required to be redeemed or prepaid as to principal prior to Stated Maturity according to a fixed schedule, the principal amounts thereof will be redeemed prior to stated maturity in accordance with the mandatory redemption provisions applicable thereto (in each case notwithstanding any contingent obligation to redeem bonds more

rapidly). For the term of any interest rate hedge agreement entered into in connection with any such obligations, Debt Service Requirements shall be computed by netting the amounts payable to the City under such hedge agreement from the amounts payable by the City under such hedge agreement and such obligations.

"Depository" means one or more official depository banks of the Board.

"Designated Financial Officer" means the chief executive officer of the Board, the chief financial officer of the Board, or such other financial or accounting official of the Board so designated by the City Council.

"DTC Participant" means those broker-dealers, banks, and other financial institutions reflected on the books of the Securities Depository.

"Eligible Bonds" has the meaning stated in the Liquidity Facility or, if not defined in the Liquidity Facility, means the Bonds or portions thereof for which the Liquidity Bank is obligated to pay the Purchase Price when such Bonds or portions are tendered or deemed tendered for purchase in accordance with *Section 2.6*.

"Existing Owner" of Bonds in an Auction Mode means a person who has signed a Master Purchaser's Letter delivered to a Broker-Dealer and is listed as a beneficial owner of Bonds in the records of the Auction Agent.

"Fiscal Year" means the twelve-month accounting period used by the Board in connection with the operation of the Systems, currently ending on January 31 of each year, which may be any 12 consecutive month period established by the Board, but in no event may the Fiscal Year be changed more than one time in any three calendar year period.

"Fitch" means Fitch Ratings, a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, **"Fitch"** shall mean any other nationally recognized securities rating agency designated by the Board and acceptable to the Credit Enhancer.

"Fixed Mode" for any Bond or portion thereof means any period of time, determined in accordance with *Section 2.2C*, during which interest on such Bond or portion accrues at the Fixed Rate therefor.

"Fixed Rate" has the meaning stated in *Section 2.2B*, determined in accordance with *Section 2.2E(5)*.

"Government Obligations" shall mean (1) direct noncallable obligations of the United States, including obligations that are unconditionally guaranteed by, the United States of America; (2) noncallable obligations of an agency or instrumentality of the United States, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that, on the date the governing body of the issuer adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent; or (3) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that, on the date the governing body of the issuer adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than AAA or its equivalent.

"Holder" of any Bond means the Person in whose name such Bond is registered in the Securities Register, subject to *Section 4.2H*.

"Hold Order" has the meaning specified in *Section 2.3A(1)*.

"Ineligible Owner" of Bonds means (1) the City, (2) any person (whether for-profit or not-for-profit) which "controls" or is "controlled" by or is under common "control" with the City, and (3) any person who owns such Bonds on behalf or for the benefit or account of the City or a person described in the preceding *Clause (2)*. For purposes of this definition, a person "controls" another person when the first person possesses or exercises, directly or indirectly through one or more other affiliates or related entities, the power to direct the management and policies of the other person, whether through the ownership of voting rights, membership, the power to appoint members, trustees, or directors, by contract, or otherwise.

"Inferior Lien Obligations" means (1) any bonds, notes, warrants, certificates of obligation, or other Debt hereafter issued by the City that are payable from and equally and ratably secured by a lien on and pledge of the Net Revenues that is

subordinate and inferior to the pledges thereof securing payment of the currently outstanding Senior Lien Obligations, the Bonds, the Commercial Paper Obligations, and any Additional Senior Lien Obligations and Additional Junior Lien Obligations hereafter issued by the City, (2) any obligations that are issued subject to the limitations in Section 1502.052, as amended, Texas Government Code, and (3) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or in part, by such an inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

"Initial Bond" has the meaning stated in *Section 2.9*.

"Interest Mode" means any Daily Mode, Weekly Mode, Auction Mode, Commercial Paper Mode, Term Mode, or Fixed Mode.

"Interest Payment Date" for any Bond or portion thereof means the date specified in such Bond as a fixed date on which interest on such Bond or portion is due and payable.

"Interest Period" for any Bond or portion thereof means the period of time from and including the Closing Date or any Rate Adjustment Date for such Bond or portion, as applicable, to but excluding the next succeeding Rate Adjustment Date for, or the Maturity of, such Bond or portion, as applicable.

"LIBOR" on any date of determination means the most recently published London Interbank Borrowing Rate (LIBOR) for loans with a term closest to the term of the applicable ensuing Interest Period for the Bonds in an Auction Mode, determined by the Market Agent.

"Liquidity Bank" means Bank of America, N.A., a national banking association organized under the laws of the United States of America, in its capacity as obligor on the initial Liquidity Facility, and its successors in such capacity and assigns permitted by the terms thereof, until the initial Liquidity Facility is released pursuant to *Section 4.1B(4)* or *(5)*, and thereafter **"Liquidity Bank"** shall mean the obligor on any alternate Liquidity Facility accepted by the Paying Agent/Registrar in substitution therefor pursuant to *Section 4.1C* and its successors in such capacity and assigns permitted by the terms thereof.

"Liquidity Facility" means that certain Standby Bond Purchase Agreement, dated as of May 15, 2003, among the Paying Agent/Registrar (for the benefit of the Holders), the City, and the initial Liquidity Bank and any amendments and extensions thereof accepted by the Paying Agent/Registrar in accordance with the provisions of *Section 4.1C*, until such Liquidity Facility is released pursuant to *Section 4.1B(4)* or *(5)*, and thereafter **"Liquidity Facility"** shall mean any alternate obligation accepted by the Paying Agent/Registrar in substitution therefor pursuant to *Section 4.1C* and any amendments and extensions thereof so accepted.

"Maintenance and Operating Expenses" means those expenses (not paid from the proceeds of any Debt) required by law (Section 1502.056, as amended, Texas Government Code) to be a first lien on and charge against the income of the Systems, including the cost of insurance; the purchase and carrying of stores, materials, and supplies; the purchase, manufacture, and production of gas and electricity for distribution and resale; the payment of salaries; and the payment of all other expenses properly incurred in operating and maintaining the Systems and keeping them in good repair and operating condition (classed as a maintenance and operating expense as opposed to a capital expenditure under the Uniform System of Accounts adopted by the National Association of Regulatory Utility Commissioners). Depreciation on the properties of the Systems shall not be considered or included as Maintenance and Operating Expenses in the determination of Net Revenues of the Systems.

"Market Agent" for the Bonds in an Auction Mode means the Person appointed as **"Market Agent"** by the City pursuant to *Section 2.6F*, until a substitute Market Agent is appointed pursuant to such Section, and thereafter **"Market Agent"** shall mean such successor.

"Market Agent Agreement" means a Market Agent Agreement entered into between the Paying Agent/Registrar and a Market Agent, as amended and supplemented from time to time in accordance with its terms.

"Market Agent Fee Rate" for any Interest Period for Bonds in an Auction Mode means the rate per annum necessary to accrue the fees, if any, and reimbursement of costs of rating maintenance and opinions of counsel payable by the Auction Agent to the Market Agent pursuant to its Market Agent Agreement.

"Market Day" means a day other than a Saturday, Sunday, or other day on which the New York Stock Exchange or banks generally are authorized to close in New York, New York, or San Antonio, Texas, or on which the Auction Agent or any Broker-Dealer is not open for business; *provided, however*, that April 14, April 15, December 24, December 30, and December 31 shall not be considered Market Days with respect to the determination of Auction Dates.

"Market Rate" means the rate determined on any Rate Determination Date pursuant to *Section 2.2E(6)*.

"Master Purchaser's Letter" for the Bonds in an Auction Mode means a letter in form and substance satisfactory to the Paying Agent/Registrar Agent and the Market Agent and attached to the Broker-Dealer Agreements, addressed to a Broker-Dealer, among others, in which a Person agrees, among other things, to offer to purchase, to purchase, to offer to sell and/or to sell Bonds in accordance with the Auction Procedures.

"Maturity" when used with respect to any Bond means the date on which the principal of such Bond becomes due and payable as therein or herein provided, whether at the Stated Maturity or by declaration of acceleration or call for redemption or otherwise, but does not include payment of the portion of the Purchase Price corresponding to principal of such Bond pursuant to *Section 2.6*.

"Maximum Rate" for any Interest Period for Bonds in an Auction Mode means a per annum interest rate equal to the lesser, all determined as of the preceding Market Day, of (1) the product of the Applicable Percentage and the Reference Rate or (2) 15% per annum minus the Service Charge Rate for such Interest Period; *provided* that if the Bonds are not then Book-Entry Only Bonds on such Market Day, the **"Maximum Rate"** for such Bonds and Interest Period shall mean an interest rate per annum equal to the lesser, determined as of such Market Day, of (1) the Applicable Percentage multiplied by the Reference Rate or (2) 15% per annum.

"Minimum Rate" for any Interest Period for Bonds in an Auction Mode means an interest rate per annum equal to 45% (as such percentage may be adjusted pursuant to *Section 2.3G*) of the Reference Rate on the Market Day preceding such Interest Period; *provided, however*, that in no event shall such Minimum Rate exceed the excess of (a) 15% per annum over (b) the Service Charge Rate for such Interest Period; and *provided, further*, that the Minimum Rate shall not exceed the Maximum Rate.

"Moody's" means Moody's Investors Services, Inc., a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, **"Moody's"** shall be deemed to refer to any other nationally recognized Rating Service designated by the Board and acceptable to the Credit Enhancer.

"Net Revenues" means all income and revenues from the operation of the Systems after the deduction of Maintenance and Operating Expenses. The term *Net Revenues* shall also include any additional and further security for the payment of the Bonds as may be pledged therefor consistent with the then applicable laws of the State of Texas, provided that any such additional and further security is made equally and ratably applicable as security for all Outstanding Bonds.

"No Auction Rate" has the meaning stated in paragraph (l)(v) of the insert to the Bonds set forth in *Section 2.2B*.

"Notice of Fee Rate Change" means a notice of a change in the Auction Agent Fee Rate or a Broker-Dealer Fee Rate substantially in the form set forth in the Auction Agreement.

"Opinion of Counsel" means a written opinion of counsel who may (except as otherwise expressly provided in this Ordinance) be counsel for one or more of the City, the Credit Enhancer, or the Liquidity Bank and, when given with respect to the status of interest on any Bond under federal income tax law, shall be counsel of nationally recognized standing in the field of municipal bond law and, when given with respect to any matter under the Bankruptcy Code, shall be counsel of nationally recognized standing in the field of bankruptcy law.

"Order" means a Hold Order, Bid, or Sell Order.

"Ordinance" means this ordinance adopted by the City Council.

"Outstanding" when used in this Ordinance with respect to Bonds means, as of the date of determination, all Bonds issued and delivered under this Ordinance, *except*:

(1) **Cancelled Bonds:** those Bonds canceled by the Paying Agent/Registrar or delivered to the Paying Agent/Registrar for cancellation;

(2) **Defeased Bonds:** those Bonds for which payment has been duly provided by the City in accordance with the provisions of *Section 4.5* by the irrevocable deposit with the Paying Agent/Registrar, or an authorized escrow agent, of money or Government Obligations, or both, in the amount necessary to fully pay the principal of, premium, if any, and interest thereon to Maturity; *provided that*, (a) if such Bonds are to be redeemed, notice of redemption thereof shall have been duly given pursuant to this Ordinance or irrevocably provided to be given to the satisfaction of the Paying Agent/Registrar, or waived, (b) if such Bonds are in a Daily Mode or Weekly Mode, such Bonds are to be redeemed within 30 days after such deposit, and if such Bonds are in an Auction Mode, Commercial Paper Mode, or Term Mode, such Bonds or portions thereof are to be redeemed on the next Rate Adjustment Date therefor, (c), if a Liquidity Facility is in effect hereunder, an Opinion of Counsel acceptable to each Rating Service is delivered to the Paying Agent/Registrar to the effect that no payment of principal of (and premium, if any) or interest on such Bonds made from such deposit may be avoided or otherwise recovered under Section 547 (either directly or by application of Section 550) of the Bankruptcy Code or any similar provision of state law, except possibly as a payment to an "insider" of the City, as defined in Section 101 of the Bankruptcy Code, and (d) unless such Bonds are in a Fixed Mode, the Paying Agent/Registrar shall have received written confirmation from each Rating Agency that no rating assigned by it to the Bonds will be withdrawn or reduced as a result of such Bonds no longer being Outstanding; and

(3) **Replaced Bonds:** those Bonds that have been mutilated, destroyed, lost, or stolen and replacement Bonds have been registered and delivered in lieu thereof as provided in *Section 2.12*.

"**Overdue Rate**" for any Interest Period in an Auction Mode means a per annum rate of interest determined on the first day of such Interest Period equal to the lesser of (1) 300% (or such other percentage, if any, to which such percentage has been adjusted pursuant to *Section 2.3G(1)*) of the Reference Rate on such day or (2) 15% per annum.

"**Paying Agent/Registrar**" means the financial institution specified in *Section 2.4* or its herein permitted successors and assigns.

"**Payment Default**" has the meaning stated in *paragraph (1)(vii)* of the insert to the Bonds set forth in *Section 2.2B*. A Payment Default shall "**exist**" if it shall have occurred and be continuing.

"**Person**" means any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, or government or any agency or political subdivision thereof.

"**Place of Payment**" for Bonds means the city in which is located the office designated by the Paying Agent/Registrar at which principal of the Bonds shall be paid at Maturity.

"**Potential Owner**" of Bonds in an Auction Mode means any Person, including any Existing Owner of such Bonds, who (1) shall have executed a Master Purchaser's Letter delivered to a Broker-Dealer and (2) may be interested in acquiring a new or additional beneficial interest in Bonds or portions thereof.

"**Predecessor Bond**" has the meaning stated in *Section 2.8H*.

"**Prevailing Rating**" of the Bonds in an Auction Mode means the then current rating by S&P, Moody's, and Fitch, or the equivalent of each such rating by a substitute Rating Service selected as provided below, and will be:

(1) "AAA" if the Bonds have a rating of "AAA" by S&P, a rating of "Aaa" by Moody's, and a rating of "AAA" by Fitch, or the equivalent of such rating by a substitute Rating Service selected as provided below;

(2) if not "AAA"," then "AA" if the Bonds have a rating of "AA-" or better by S&P, "Aa3" or better by Moody's, and "AA-" or better by Fitch, or the equivalent of such rating by a substitute Rating Service selected as provided below;

(3) if not "AAA" or "AA"," then "A" if the Bonds have a rating of "A-" or better by S&P, a rating of "A3" or better by Moody's, and a rating of "A-" or better by Fitch, or the equivalent of such rating by a substitute Rating Service selected as provided below;

(4) if not "AAA", "AA", or "A", then "BBB" if the Bonds have a rating of "BBB-" or better by S&P, a rating of "Baa3" or better by Moody's, and a rating of "BBB-" or better by Fitch, or the equivalent of such rating by a substitute Rating Service selected as provided below; and

(5) if not "AAA", "AA", "A", or "BBB", then Below "BBB", whether or not the Bonds are rated by any securities rating agency.

If (a) the Bonds are rated by a nationally recognized securities statistical rating agency or agencies other than S&P, Moody's, or Fitch because S&P, Moody's, or Fitch ratings are not available, and (b) the City has delivered to the Paying Agent/Registrar and the Auction Agent an instrument designating one, two, or three of such rating agencies to replace S&P, Moody's, and Fitch, then for purposes of the definition S&P, Moody's, and Fitch will be deemed to have been replaced in accordance with such instrument; *provided, however*, that such instrument must be accompanied by the consent of the Market Agents. For purposes of this definition, S&P's rating categories of "AAA," "AA-," "A-," and "BBB-," Moody's rating categories of "Aaa," "Aa3," "A3," and "Baa3," and Fitch's rating categories of "AAA," "AA-," "A-," and "BBB-" refer to and include the respective rating categories correlative thereto in the event that such rating agencies have changed or modified their generic rating categories. If the prevailing ratings for the Bonds are split between categories set forth above, the lower rating will determine the Prevailing Rating.

"Purchase Date," when used with respect to any Bond or portion thereof, means the date upon which the Paying Agent/Registrar is obligated to effect the purchase of such Bond or portion on the terms described in *Section 2.6A*.

"Purchase Fund" means the fund of the Paying Agent/Registrar so defined in *Section 2.6C*.

"Purchase Price" of any Bond (or portion thereof) required to be purchased pursuant to the terms of *Section 2.6A* means an amount equal to 100% of the principal amount of such Bond (or portion), plus interest, if any, accrued thereon (excluding the Bank Differential, if any, therefor) to the Purchase Date from the most recent Interest Payment Date therefor to which interest thereon has been paid or duly provided for.

"Purchaser" shall mean the initial purchaser of the Bonds named in *Section 2.13* of this Ordinance.

"Rate Adjustment Date" for any Bond or portion thereof means each day on which such Bond or portion will, unless a Bank Bond, begin to bear interest at a new Daily Rate, Weekly Rate, Auction Rate, Commercial Paper Rate, Term Rate, or Fixed Rate determined in accordance with *Section 2.2E(6)*, whether or not such rate is different from the interest rate previously in effect on the Bonds.

"Rate Determination Date" for any Bond or portion thereof means each date on which the Remarketing Agent is required to make a determination of the Daily Rate, Weekly Rate, initial Auction Rate, Commercial Paper Rate, Term Rate, or Fixed Rate to be borne by such Bond or portion pursuant to *Section 2.2E(6)*.

"Rating Service" means each nationally recognized securities rating service which at the time has a credit rating assigned to the Bonds.

"Record Date" has the meaning stated in *Section 2.2B*.

"Reference Rate" for the Bonds or portions thereof in any Interest Period in an Auction Mode means (1) if such Interest Period is six months or shorter, then the product of LIBOR for such Interest Period and the "AA" Composite Commercial Paper Rate as of the Market Day preceding such Interest Period and (2) if such Interest Period is longer than six months, then the greater of LIBOR for such Interest Period and the yield on United States Treasury obligations having a maturity date that most closely approximates the duration of such Interest Period.

"Remarketing Agent" means the Person named as "Remarketing Agent" in *Section 2.6F*, until a substitute Remarketing Agent becomes such pursuant to such Section, and thereafter **"Remarketing Agent"** shall mean such successor.

"Remarketing Agreement" means the Remarketing Agreement, dated as of May 1, 2003, between the City and the initial Remarketing Agent, until the City shall have entered into a substitute agreement pursuant to *Section 2.6F* to provide for the remarketing of Bonds, and thereafter **"Remarketing Agreement"** shall mean such substitute agreement.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successors and their assigns, and, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, **"S&P"** shall be deemed to refer to any other nationally recognized securities rating agency designated by the Board and acceptable to the Credit Enhancer.

"Securities Depository" means The Depository Trust Company or any successor person appointed by ordinance of the City Council to act as Holder of the Bonds, directly or through a nominee, to maintain a system for recording and transferring beneficial interests in such Bonds and distributing payments thereon and notices in respect thereof.

"Securities Register" has the meaning stated in *Section 2.4*.

"Sell Order" has the meaning specified in *Section 2.3A(1)*.

"Senior Lien Obligations" means (1) the outstanding and unpaid obligations of the City that are payable solely from and equally and ratably secured by a prior and first lien on and pledge of the Net Revenues of the Systems, identified as follows:

"City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1992", dated August 1, 1992 and originally issued in the total aggregate principal amount of \$700,805,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1994-A", dated February 1, 1994 and originally issued in the total aggregate principal amount of \$684,700,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1994-C", dated February 23, 1994 and originally issued in the total aggregate principal amount of \$56,000,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue Bonds, New Series 1995", dated October 15, 1995 and originally issued in the total aggregate principal amount of \$125,000,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue and Refunding Bonds, New Series 1997", dated May 1, 1997 and originally issued in the total aggregate principal amount of \$661,170,000

"City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1998A", dated November 1, 1998 and originally issued in the total aggregate principal amount of \$785,515,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, Taxable New Series 1998B", dated November 1, 1998 and originally issued in the total aggregate principal amount of \$99,615,000;

"City of San Antonio, Texas Electric and Gas Systems Revenue Bonds, New Series 2000A", dated November 15, 2000 and originally issued in the total aggregate principal amount of \$170,770,000;

"City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, Taxable New Series 2000B", dated November 15, 2000 and originally issued in the total aggregate principal amount of \$50,425,000;

"City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2001", dated October 1, 2001 and originally issued in the total aggregate principal amount of \$115,280,000;

"City of San Antonio, Texas, Electric and Gas Systems Revenue and Refunding Bonds, New Series 2002", dated August 1, 2002 and originally issued in the total aggregate principal amount of \$576,705,000; and

(2) obligations hereafter issued to refund any of the foregoing if issued in a manner so as to be payable from and equally and ratably secured by a first lien on and pledge of the Net Revenues of the Systems as determined by the City Council in accordance with any applicable law.

"Service Charge Rate" has the meaning stated in *Section 2.2B*.

"Special Payment Date" has the meaning stated in *Section 2.4*.

“Special Record Date” has the meaning stated in *Section 2.4*.

“Stated Maturity” has the meaning stated in *Section 2.2A*.

“Submission Deadline” means 1:00 p.m., New York, New York, time, on each Auction Date or such other time on an Auction Date as shall be specified from time to time by the Auction Agent pursuant to the Auction Agreement as the time by which Broker-Dealers are required to submit Orders to the Auction Agent.

“Submitted Bid” has the meaning specified in *Section 2.3C(1)*.

“Submitted Hold Order” has the meaning specified in *Section 2.3C(1)*.

“Submitted Sell Order” has the meaning specified in *Section 2.3C(1)*.

“Substitute Commercial Paper Dealers” for the Bonds in an Auction Mode means such commercial paper dealers (other than the Commercial Paper Dealers) as the Market Agent may from time to time designate as such.

“Sufficient Clearing Bids” has the meaning stated in *Section 2.3C(1)*.

“Systems” means the entire electric light and power plants and systems and gas distribution system and all property of every kind appurtenant to and used or acquired in connection with said electric light and power plant and systems and gas distribution system owned by the City, together with all property of every kind now and hereafter owned or acquired by the City as a part of or for use in the operation of the City’s electric light and power plants and systems and gas distribution system. Notwithstanding the foregoing, upon payment in full, or provision for such payment, of the Senior Lien Obligations issued before May 29, 1997, and the defeasance of the ordinances authorizing the issuance of such Senior Lien Obligations, the term Systems shall not mean or include facilities of any kind which are declared not to be a part of the Systems and which are acquired or constructed by or on behalf of the City with the proceeds from the issuance of Special Facilities Bonds, which are hereby defined as being special revenue obligations of the City which are not payable from Net Revenues but which are payable from and equally and ratably secured by other liens on and pledges of any revenues, sources or payments, not pledged to the payment of the Senior Lien Obligations including, but not limited to, special contract revenues or payments received from any other legal entity in connection with such facilities.

“Term Mode” for any Bond or portion thereof means any period of time, determined in accordance with *Section 2.2C*, during which interest on such Bond or portion (except when a Bank Bond) accrues at the Term Rate therefor.

“Term Rate” for any Bond or portion thereof has the meaning stated in *Section 2.2B*, to be determined in accordance with *Section 2.2E(5)*.

“Untendered Bonds” has the meaning stated in *Section 2.6E*.

“Weekly Mode” for any Bond means any period of time, determined in accordance with *Section 2.2B* and *2.2C*, during which interest on such Bond (except when a Bank Bond) accrues at the Weekly Rate therefor.

“Weekly Rate” has the meaning stated in *Section 2.2B*, to be determined in accordance with *Section 2.2E(2)*.

“Winning Bid Rate” at an Auction for the Bonds in an Auction Mode means the lowest rate specified in any Submitted Bid for such Bonds made at such Auction which, if selected by the Auction Agent as the Auction Rate for such Bonds, would cause the aggregate principal amount of Outstanding Bonds that are the subject of Submitted Bids specifying a rate not greater than such rate to be not less than the aggregate principal amount of Available Bonds.

SECTION 4.3. Pledge of Net Revenues.

(a) Payment of the principal of and interest on (but not the Purchase Price of) the Bonds and the obligations of the City under the Liquidity Facility are and shall be secured by and payable solely from, and the City hereby grants a junior lien on and pledge of, the Net Revenues, subject and subordinate to the liens on and pledges of Net Revenues heretofore or hereafter made to secure payment of the Senior Lien Obligations and the Additional Senior Lien Obligations (and equally and ratably with the lien on and pledge of Net Revenues heretofore or hereafter made to secure payment of Additional Junior Lien Obligations). Neither the Bonds nor the Liquidity Facility is secured by or payable from a mortgage or deed of

trust on any properties, whether real, personal, or mixed, constituting the Systems. The Bonds are being issued as junior lien obligations.

(b) Chapter 1208, Texas Government Code, applies to the issuance of the Bonds and the pledge of Net Revenues granted by the City under subsection (a) of this Section, and such pledge is therefore valid, effective, and perfected. If Texas law is amended at anytime while the Bonds are outstanding and unpaid such that the pledge of the Net Revenues granted by the City is to be subject to the filing requirements of Chapter 9, Texas Business & Commerce Code, then in order to preserve to the registered owners of the Bonds the perfection of the security interest in this pledge, the Board agrees to take such measures as it determines are reasonable and necessary under Texas law to comply with the applicable provisions of Chapter 9, Texas Business & Commerce Code and enable a filing to perfect the security interest in this pledge to occur.

(c) The Bonds are special obligations of the City payable from a lien on and pledge of the Net Revenues, and the holders thereof shall never have the right to demand payment out of funds raised or to be raised by taxation.

SECTION 4.4. Satisfaction of Obligation of City.

When no Bond remains Outstanding and the obligations of the City under the Liquidity Facility have been paid in full or otherwise discharged, then the lien on and pledge of Net Revenues under this Ordinance and all covenants, agreements, and other obligations of the City to the Holders shall thereupon cease, terminate, and be discharged and satisfied.

To provide for the payment of the principal of, premium, if any, and interest on any Bond, the City may irrevocably deposit in trust with the Paying Agent/Registrar, or an authorized escrow agent, (a) money sufficient to pay in full such principal, premium, if any, and interest at Stated Maturity or to the redemption date therefor and/or (b) Government Securities certified by an independent accounting firm, or such other persons as permitted by the laws of the State of Texas, to mature as to principal and interest in such amounts and at such times as will insure the availability, without reinvestment, of sufficient money, together with any money deposited therewith, if any, to pay when due the principal of, premium, if any, and interest on such Bond on and prior to the Stated Maturity thereof or (if notice of redemption has been duly given or waived or if irrevocable arrangements therefor acceptable to the Paying Agent/Registrar have been made) the redemption date thereof. The City covenants that no deposit of money or Government Securities will be made under this Section and no use made of any such deposit which would cause the Bonds to be treated as arbitrage bonds within the meaning of section 148 of the Code.

Any money so deposited with the Paying Agent/Registrar, and all income from Government Securities held in trust by the Paying Agent/Registrar, or an authorized escrow agent, pursuant to this Section which is not required for the payment of the Bonds, or any principal amount(s) thereof, or interest thereon with respect to which such money has been so deposited shall be remitted to the Board or deposited as directed by the Board. Furthermore, any money held by the Paying Agent/Registrar for the payment of the principal of, premium, if any, or interest on the Bonds and remaining unclaimed for a period of four (4) years after the Stated Maturity, or applicable redemption date, of the Bonds such money was deposited and is held in trust to pay shall upon the request of the Board be remitted to the Board against a written receipt therefor, subject to the unclaimed property laws of the State of Texas.

Notwithstanding any other provision of this Ordinance to the contrary, it is hereby provided that any determination not to redeem defeased Bonds that is made in conjunction with the payment arrangements specified in Clause (a) or (b) above shall be revocable, provided that the City (1) in the proceedings providing for such defeasance, expressly reserves the right to call the defeased Bonds for redemption; (2) gives notice of the reservation of that right to the owners of the defeased Bonds immediately following the defeasance; (3) directs that notice of the reservation be included in any redemption notices that it authorizes; and (4) at the time of the redemption, satisfies the conditions of Clause (a) or (b) above with respect to such defeased Bonds as though it was being defeased at the time of the exercise of the option to redeem the defeased Bonds, after taking the redemption into account in determining the sufficiency of the provisions made for the payment of the defeased Bonds.

SECTION 5.1. General Account.

The City, acting through the Board, hereby covenants with respect to the holders of the Bonds that all revenues of every nature received through the operation of the Systems shall be deposited as received in the "City of San Antonio Electric and Gas Systems General Account" (the "General Account"), which shall be kept separate and apart from all other funds of the City. Revenues received for the General Account shall be deposited from time to time as received in such Depository as may be selected by the Board in accordance with applicable laws relating to the selection of political

subdivision depositories. All gross revenues deposited into the General Account shall be pledged and appropriated to the extent required for the following uses and in the order of priority shown:

FIRST: to the payment of reasonable and proper Maintenance and Operating Expenses of the Systems upon approval by the Board of Trustees;

SECOND: to the payment of the currently outstanding Senior Lien Obligations or any Additional Senior Lien Obligations hereafter issued by the City, including the establishment and maintenance of the reserve therefor;

THIRD: to the payment of the Bonds or any Additional Junior Lien Obligations hereafter issued by the City or any Prior Lien Bonds (as defined in the ordinance authorizing the Commercial Paper Obligations), including the establishment and maintenance of a reserve therefor;

FOURTH: to the payment and security of the Notes and the Agreement (each as defined in the ordinance authorizing the Commercial Paper Obligations);

FIFTH: to the payment and security of any Inferior Lien Obligations, including obligations hereinafter issued which are inferior in lien on the Senior Lien Obligations, any Additional Senior Lien Obligations, the Bonds, any Additional Junior Lien Obligations, and the Notes;

SIXTH: to the payment of an annual amount equal to six percent (6%) of the gross revenues of the Systems to be deposited in the Repair and Replacement Account (created in the ordinances authorizing the Senior Lien Obligations) provided in Section 5.4 of this Ordinance;

SEVENTH: to the payment of the annual amount due the General Fund of the City, as provided in Section 5.3 of this Ordinance; and

EIGHTH: any remaining Net Revenues of the Systems in the General Account, to the Repair and Replacement Account in accordance with Section 5.4 of this Ordinance.

Any Net Revenues remaining in the General Account after satisfying the foregoing payments, or making adequate and sufficient provision for the payment thereof, may be appropriated and used for any other Board purpose now or hereafter permitted by law and the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations.

SECTION 5.2. Bond Fund; Excess Bond Proceeds.

For purposes of providing funds to pay the principal of and interest on, and other amounts payable under, the Bonds, the Liquidity Facility, any Credit Facility, the Remarketing Agreement, and the Paying Agent/Registrar Agreement, as the same become due and payable, and for so long as any Bonds remain Outstanding or the City remains obligated under any other such agreement, the City agrees to maintain, at the Depository, a separate and special Fund or account to be created and known as the "City of San Antonio, Texas, Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003 Interest and Sinking Fund" (herein referred to as the "Bond Fund"). The City covenants that there shall be deposited into the Bond Fund prior to each payment date from the available Net Revenues an amount equal to one hundred per cent (100%) of the amount required to fully make such payments when due and payable, such deposits to be made in substantially equal monthly installments whenever Bonds are in a Term Mode or Fixed Mode. If the Net Revenues in any month are insufficient to make the required payments into the Bond Fund, then the amount of any deficiency in such payment shall be added to the amount otherwise required to be paid into the Bond Fund in the next month.

Any proceeds of the Bonds, and investment income thereon, not expended for authorized purposes shall be deposited into the Bond Fund and shall be taken into consideration and reduce the amount of monthly deposits required to be deposited into the Bond Fund from the Net Revenues of the Systems.

SECTION 5.3. Payments to City General Fund.

In accordance with the provisions of the ordinances authorizing the issuance of the Senior Lien Obligations and this Ordinance, and after the payments required by Clauses First through Fifth of Section 5.1 and to the Repair and Replacement Account (for purposes of accumulating therein an amount equal to six percent (6%) of the annual gross revenues of the Systems) have been made in full in accordance with the provisions of this Ordinance, there shall be paid over or credited to

the General Fund of the City (for general purposes of the City), to the extent Net Revenues of the Systems are available in the General Account and in monthly installments, an amount in cash not to exceed 14% of the gross revenues of the Systems for the month next preceding the month in which the monthly deposit is made, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amount expended for additions to the street lighting system for the month for which such payment is being made. The maximum amount in cash to be transferred or credited to the General Fund of the City from the Net Revenues of the Systems during any Fiscal Year shall not exceed 14% of the gross revenues of the Systems less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the Fiscal Year for additions to the street lighting system. The percentage of gross revenues of the Systems to be paid over or credited to the General Fund of the City each Fiscal Year shall be determined (within the 14% limitation) by the governing body of the City.

SECTION 5.4. Repair and Replacement Account.

The City reaffirms the prior creation and establishment of a special fund or account to be known as the "City of San Antonio Electric and Gas Systems Repair and Replacement Account" (the "Repair and Replacement Account") at such Depository as may be designated by the Board of Trustees. Money on deposit in the Repair and Replacement Account shall be used for the following purposes: providing extensions, additions, and improvements to the Systems; meeting contingencies of any nature in connection with the operations, maintenance, improvement, replacement, or restoration of properties of the Systems; and paying bonds or other obligations for which other funds are not available, or for any or all of such purposes, as, from time to time, may be determined by the Board of Trustees.

From the Net Revenues remaining in the General Account after payment and provisions for payments and additions to the Bond Fund in accordance with the provisions of Section 5.2, there shall be paid into the Repair and Replacement Account an annual sum equal to six percent (6%) of the gross revenues of the Systems for the then current Fiscal Year. This annual payment to the Repair and Replacement Account shall be accumulated each Fiscal Year by monthly installments, such monthly installments to be based on each month's gross revenues to the extent funds in the General Account are available each month; provided, however, should the total annual payment to the Repair and Replacement Account in any Fiscal Year exceed six percent (6%) of the gross revenues of the Systems, as shown by the Systems' audited annual financial statement, proper year-end adjustments shall be made (on or before March 1 after the close of each Fiscal Year) by causing any excess amount deposited therein to be transferred to the General Account.

No deposit in excess of six percent (6%) of the annual gross revenues of the Systems shall be made to the Repair and Replacement Account (as provided in the preceding paragraph) unless and until complete and full payments, or provisions for such payments, shall have been paid over or credited to the General Fund of the City in accordance with Section 5.3 of this Ordinance. After complete and full payments, or provisions for such payments, shall have been paid over or credited to the General Fund of the City to the full extent required in Section 5.3 hereof, additional deposits may be made to the Repair and Replacement Account; and at the close of each Fiscal Year, all Net Revenues of the Systems remaining in the General Account after full and complete payment to the General Fund of the City has been made (except such amounts as may be required to meet unpaid accounts and obligations which have accrued or are payable during the year to insure continued operation of the Systems), shall be deposited in the Repair and Replacement Account.

SECTION 6.1. Application of the Covenants and Agreements of the Senior Lien Obligations.

It is the intention of the City Council and accordingly hereby recognized and stipulated that the provisions, agreements, and covenants contained herein bearing upon the management and operations of the Systems, and the administration and application of gross revenues derived from the operation thereof, shall to the extent possible be harmonized with like provisions, agreements, and covenants contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, and to the extent of any irreconcilable conflict between the provisions contained herein and in the ordinance authorizing the issuance of the currently outstanding Senior Lien Obligations, the provisions, agreements and covenants contained therein shall prevail to the extent of such conflict and be applicable to this Ordinance, especially the priority of rights and benefits conferred thereby to the holders of the currently outstanding Senior Lien Obligations. It is expressly recognized that, prior to the issuance of any Additional Senior Lien Obligations or Additional Junior Lien Obligations, the City must comply with each of the conditions precedent contained in this Ordinance and the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, as appropriate.

SECTION 6.2. Issuance of Additional Senior Lien Obligations, Additional Junior Lien Obligations, and Inferior Lien Obligations

The City hereby expressly reserves the right to hereafter issue bonds, notes, warrants, certificates of obligation, or similar obligations payable wholly or in part from and secured by a pledge of and lien on the Net Revenues of the Systems with the following priorities, without limitation as to principal amount, but subject to any terms, conditions, or restrictions applicable thereto under existing ordinances, laws, or otherwise:

A. Senior Lien: Additional Senior Lien Obligations payable from and equally and ratably secured by a first and prior lien on and pledge of the Net Revenues of the Systems upon (1) satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations or, in the event no Senior Lien Obligations are outstanding, the conditions precedent contained in the most recently adopted ordinance authorizing Senior Lien Obligations and (2) execution by a Designated Financial Officer of the certificates described in Subsections B(1) and B(2) of this Section, taking into account the Senior Lien Obligations then proposed to be issued;

B. Junior Lien: Additional Junior Lien Obligations payable from and equally and ratably secured by a junior lien on and pledge of the Net Revenues that is subordinate and inferior to the liens and pledges made to secure payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued, upon satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations and upon satisfying each of the following conditions precedent:

(1) No Default Certificate: a Designated Financial Officer (or other official of the City having primary responsibility for the fiscal affairs of the City) shall have executed a certificate stating that (a) except for a refunding to cure a default, or the deposit of a portion of the proceeds of any Additional Junior Lien Obligations to satisfy the City's obligations under this Ordinance, the City is not then in default as to any covenant, obligation, or agreement contained in any ordinance or other proceedings relating to any obligations of the City payable from and secured by a lien on and pledge of the Net Revenues of the Systems and (b) all payments into all special funds or accounts created and established for the payment and security of all outstanding obligations payable from and secured by a lien on and pledge of the Net Revenues of the Systems have been duly made and that the amounts on deposit in such special funds or accounts are the amounts then required to be deposited therein;

(2) Coverage Certificate: a Designated Financial Officer shall have executed a certificate to the effect that, according to the books and records of the Systems, the Net Revenues of the Systems for the preceding Fiscal Year or for any 12 consecutive months out of the 18 months immediately preceding the month the ordinance authorizing the Additional Junior Lien Obligations is adopted (determined without regard to revenue received by the City under any interest rate hedge agreement entered into in connection with Senior Lien Obligations, the Bonds, Additional Senior Lien Obligations, or Additional Junior Lien Obligations) are at least equal to 100% of the average annual Debt Service Requirements for all Senior Lien Obligations, the Bonds, Additional Senior Lien Obligations, and Additional Junior Lien Obligations in any future Fiscal Year while the Additional Junior Lien Obligations then proposed to be issued are to be outstanding, after giving effect to such Additional Junior Lien Obligations (and, in making a determination of the Net Revenues, such Designated Financial Officer may take into consideration a change in the rates and charges for services and facilities afforded by the Systems that became effective at least 60 days prior to the last day of the period for which Net Revenues are to be determined and, for purposes of satisfying the above Net Revenues test, make a pro forma determination of the Net Revenues for the period of time covered by the certification based on such change in rates and charges being in effect for the entire period covered by such Designated Financial Officer's certificate); and

(3) Debt Service Deposits: the ordinance authorizing the issuance of the Additional Junior Lien Obligations provides for monthly deposits to be made to a debt service fund for such obligations in amounts sufficient to pay the Additional Junior Lien Obligations when due; and

C. Inferior Lien: Commercial Paper Obligations and Inferior Lien Obligations payable from and secured by a lien on and pledge of the Net Revenues of the Systems that is inferior and subordinate to the liens and pledges made to secure payment of the Senior Lien Obligations, Additional Senior Lien Obligations, the Bonds, and Additional Junior Lien Obligations, upon satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, this Ordinance, and the ordinance authorizing the issuance of the Commercial Paper Obligations.

SECTION 6.5. Special Covenants and Representations.

The City hereby further covenants that:

A. The City has secured from the Board of Trustees a resolution acknowledging its duties, responsibilities, and obligations under this Ordinance and agreeing to fully comply with all its terms and provisions, including the administration and operation of the Systems and the disposition of revenues of the Systems.

B. It has the lawful power to pledge the Net Revenues supporting the Bonds and has lawfully exercised said power under the laws of the State of Texas, including said power existing under the Acts, and the Additional Junior Lien Obligations, when issued, shall be equally and ratably secured under said pledge of income in such manner that one bond shall have no preference over any other bond of said issues.

C. Other than for the payment of the Senior Lien Obligations, the Bonds, and the Commercial Paper Obligations, the rents, revenues and income of the Systems have not in any manner been pledged to the payment of any debt or obligation of the City or of the Systems, except that certain reimbursement agreements, indemnity agreements, credit facility agreements, and other financial or contractual arrangements which have been or may be entered into by the City grant a subordinate and inferior lien on and pledge of the Net Revenues of the Systems to secure the payment obligations of the City or the Board under these agreements which lien is subordinate and inferior to the lien on and pledge thereof securing the payment of any Maintenance and Operating Expenses, the debt service requirements on the Senior Lien Obligations, the Bonds, and the Commercial Paper Obligations, and any other provision of the ordinances authorizing the issuance of these obligations.

D. So long as any of the Bonds or any interest thereon remain Outstanding, the City will not sell or encumber the Systems or any substantial part thereof; provided that this shall not be construed to prohibit the sale of such machinery or other properties or equipment which has become obsolete or otherwise unsuited to the efficient operation of the Systems.

E. No free service of the Systems shall be allowed, and, should the City or any of its agents or instrumentalities make use of the services or facilities of the Systems, payments for services rendered by the Systems should either be made by the City or amounts equal in value to the services rendered by the Systems shall be deducted from the annual payment due the General Fund of the City from the Net Revenues of the Systems as provided in Section 5.3 hereof.

F. To the extent it legally may, the City further covenants and agrees that, so long as any Bonds or any interest thereon are Outstanding, no franchise shall be granted for the installation or operation of any competing electric or gas system other than that owned by the City, and the operation of any such systems by anyone other than the City is hereby prohibited.

SECTION 6.6. Rates and Charges.

While any of the Bonds or Additional Junior Lien Obligations authorized hereby are Outstanding, the City shall establish and maintain rates and charges for facilities and services afforded by the Systems that are reasonably expected, on the basis of available information and experience and with due allowance for contingencies, to produce income and revenues in each Fiscal Year sufficient:

A. to pay all Maintenance and Operating Expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502, as amended, Texas Government Code;

B. to produce Net Revenues, together with any other lawfully available funds, sufficient to satisfy the rate covenant contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations and to pay the interest on and principal of all Senior Lien Obligations or any Additional Senior Lien Obligations hereafter issued, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Senior Lien Obligations;

C. to produce Net Revenues, together with any other lawfully available funds, to pay the interest on and principal of all Bonds or any Additional Junior Lien Obligations hereafter issued, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Bonds;

D. to the extent the same are reasonably anticipated to be paid with Available Revenues (as defined in the ordinance authorizing the Commercial Paper Obligations), the interest on and principal of all Notes (as defined in said ordinance), and the Credit Agreement (as defined in said ordinance); and

E. to pay any Inferior Lien Obligations or any other legal debt or obligation of the Systems as and when the same shall become due.

SECTION 6.10. Management of Systems.

In accordance with the provisions of the ordinances authorizing the currently outstanding Senior Lien Obligations and this Ordinance, the City hereby agrees, covenants, and reaffirms that during such time as any Bonds issued hereunder are Outstanding and unpaid, the complete management and control of the Systems, pursuant to the authority contained in Section 1502.070, as amended, Texas Government Code, shall be vested in a Board of Trustees consisting of five citizens (one of whom shall be the Mayor of the City) of the United States of America permanently residing in Bexar County, Texas, to be known as the "City Public Service Board of San Antonio, Texas". The Mayor of the City shall be a voting member of the Board, shall represent the City Council thereon, and shall be charged with the duty and responsibility of keeping the City Council fully advised and informed at all times of any actions, deliberations and decisions of the Board and its conduct of the management of the Systems.

All vacancies in membership on the Board (excluding the Mayor of the City), whether occasioned by failure or refusal of any person previously named to accept appointment or by expiration of term of office or otherwise, shall be filled in the following manner: a nominee to fill such vacancy shall be elected by the majority vote of the remaining members of the Board of Trustees, such majority vote to include the vote of the Mayor. The name of such nominee shall then be submitted by the Mayor to the vote of the City Council, which by a majority vote of the members thereof then in office shall, as evidenced by ordinance or resolution, either confirm or reject such nominee; provided, however, if the City Council fails to act upon such nominee, such failure to do so shall be considered as a rejection of such nominee and another nominee shall be selected by the Board. If a vacancy occurs and the remaining members of the Board (including the Mayor) fail to elect a nominee to fill such vacancy within sixty (60) days after the vacancy occurs (or fail to select another nominee within sixty (60) days after rejection of a nominee by the City Council), the City Council, by a majority vote of the members thereof then in office, shall elect a person to fill such vacancy and shall appoint such Trustee by resolution or ordinance. In the event the City rejects or fails to confirm three (3) consecutive nominees of the Board to fill a vacancy on the Board, the City Council shall, within thirty (30) days after the third rejection, appoint a temporary Trustee to fill such vacancy pending the appointment of a permanent Trustee to fill such vacancy. The appointment of a temporary Trustee by the City Council shall constitute the nomination of such appointee as the permanent Trustee to fill such vacancy. Unless the remaining members of the Board, by a majority vote, reject the nominee selected by the City Council within thirty (30) days after his appointment as a temporary Trustee, the appointment shall become final and the temporary Trustee shall automatically become the permanent Trustee to fill such vacancy. In such vote, the vote of the Mayor shall automatically be cast as a vote in favor of the confirmation of such Trustee, whether cast by the Mayor or not.

If the nominee of the City Council is rejected by a majority vote of the remaining Trustees, the remaining Trustees shall within thirty (30) days after such rejection elect another nominee to fill such vacancy. Such nominee shall be considered by the City Council and if approved shall become the permanent Trustee. If such nominee is rejected by a majority vote of the members of the City Council then in office, or in the event the City Council fails to act upon such nomination within thirty (30) days after the nomination is presented to the City Council, the temporary Trustee theretofore appointed by the City Council shall automatically become the permanent Trustee to fill such vacancy. The term of office of each member appointed to the Board shall be five (5) years. A person who has served as an appointed member of the Board for a single five-year term shall be eligible for reappointment for one additional five-year term and one only. A member who is appointed to the Board to serve out an unexpired portion of a retired member's term shall not be considered to have served a "term" unless the unexpired portion of the term so served is three (3) years or more. Permanent removal of residence from Bexar County by any appointed member of the Board shall vacate his office as a member of the Board, or any member (other than the Mayor of the City) who shall be continuously absent from all meetings held by the Board for a period of four (4) consecutive months shall, unless he shall have been granted leave of absence by the unanimous vote of the remaining members of the Board, be considered to have vacated his office as a member of the Board. Any member of the Board, other than the Mayor of the City, may, by unanimous vote of the remaining members of the Board, be removed from office, but only for adequate cause.

Notwithstanding any of the foregoing provisions as contained in this Section or in any other section of this Ordinance pertaining to the appointment or selection of Trustees to the Board, the City Council reserves unto itself the absolute right at any time upon passage of an ordinance approved by a majority vote of its members to change the method of selection of and appointment to the Board of Trustees to direct selection by the City Council, with such change of method to direct selection being at the sole option of the City Council without approval of any persons, party, holder of Bonds, or the Board of Trustees.

Except as otherwise specifically provided in this Ordinance, the Board of Trustees shall have absolute and complete authority and power with reference to the control, management, and operation of the Systems and the expenditure and application of the revenues of the Systems subject to the provisions contained in this Ordinance, all of which shall be

binding upon and shall govern the Board of Trustees. In connection with the management and operation of the Systems and the expenditure and application of the revenues therefrom, the Board of Trustees shall be vested with all of the powers of the City with respect thereto, including all powers necessary or appropriate for the performance of all of the covenants, undertakings, and agreements of the City contained in this Ordinance, and shall have full power and authority to make rules and regulations governing the furnishing of electric and gas service to customers and for the payment of the same, and for the discontinuance of such services upon failure of customers to pay therefor, and, to the extent authorized by law, shall have full authority with reference to making of extensions, improvements, and additions to the Systems and the acquiring by purchase or condemnation of properties of every kind in connection therewith.

The Board of Trustees, in exercising the management powers granted herein, will ensure that policies adopted affecting research, development, and corporate planning will be consistent with City Council policy, and policies adopted by the Board of Trustees pertaining to such matters will be subject to City Council review.

The Board of Trustees shall elect one of its members as Chairman and one as Vice Chairman of the Board and shall appoint a Secretary and a Treasurer, or a Secretary-Treasurer, who may, but need not be, a member or members of the Board. If a member of the Board of Trustees is not appointed as Secretary or Treasurer, or Secretary-Treasurer, then an employee or employees of the Board whose duties in the operation of the Systems require performance of similar duties may be appointed as Secretary or Treasurer or Secretary-Treasurer. The Board of Trustees may follow and adopt such rules for the orderly handling of its affairs as it may see fit and may manage and conduct the affairs of the Systems with the same freedom and in the same manner ordinarily employed by the board of directors of private corporations operating properties of a similar nature. No member of the Board of Trustees, however, shall ever vote by proxy in the exercise of his duties as a Trustee.

The Board of Trustees shall appoint and employ all officers, employees, and professional consultants which it may deem desirable, including without limitation, a General Manager and CEO of the Systems, attorneys, engineers, architects, and other advisors. No officer or employee of the Board of Trustees may be employed who shall be related within the second degree of consanguinity or affinity to any member of the Board of Trustees.

The Board of Trustees shall obtain and keep continually in force an employees' fidelity and indemnity bond of the so-called "blanket" type, written by a solvent and recognized indemnity company authorized to do business in the State of Texas and covering losses to the amount of not less than One Hundred Thousand Dollars (\$100,000).

The members of the Board of Trustees, other than the Mayor of the City, shall receive annual compensation in the minimum amount of Two Thousand Dollars (\$2,000.00), except that the Chairman of the Board shall receive annual compensation in the minimum amount of Two Thousand Five Hundred Dollars (\$2,500.00). Such compensation may be increased from time to time by the majority vote of the City Council then in office.

The members of the Board of Trustees and administrative officers shall not be personally liable, either individually or collectively, for any act or omission not willfully fraudulent or in bad faith.

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APPENDIX D



CPS ENERGY

FORM OF OPINION OF CO-BOND COUNSEL

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Fulbright & Jaworski L.L.P.
300 Convent Street, Suite 2200
San Antonio, Texas 78205

Escamilla & Poneck, Inc.
711 Navarro, Suite 100
San Antonio, Texas 78205

FINAL

IN REGARD to the authorization and issuance of the City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003 (the *Bonds*), dated the date hereof, in the aggregate principal amount of \$250,000,000 we have reviewed the legality and validity of the issuance thereof by the City of San Antonio, Texas (the *City*). The Bonds are issuable in fully registered form only and are stated to mature as provided in the Ordinance of the City Council of the City authorizing the issuance of the Bonds (the *Ordinance*), unless redeemed prior to stated maturity in accordance with the terms stated in the Ordinance. Interest on the Bonds accrues from the dates, at the rates, and in the manner, and is payable on the dates as provided in the Ordinance

WE HAVE SERVED AS CO-BOND COUNSEL for the City solely to pass upon the legality and validity of the issuance of the Bonds under the laws of the State of Texas and the exemption of the interest on the Bonds from federal income taxes and for no other purpose. We have not been requested to investigate or verify, and have not independently investigated or verified, any records, data, or other material relating to the financial condition or capabilities of the City or the City's electric and gas systems and have not assumed any responsibility with respect thereto. We express no opinion and make no comment with respect to the sufficiency of the security for or the marketability of the Bonds. Our role in connection with the City's Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

WE HAVE EXAMINED, and in rendering the opinions herein we rely upon, original or certified copies of the proceedings of the City Council of the City in connection with the issuance of the Bonds, including the Ordinance; a resolution adopted by the Board of Trustees (the *Board*) of the City Public Service Board of San Antonio; Texas customary certifications and opinions of officials of the City and the Board; certificates executed by officers of the City and the Board relating to the expected use and investment of proceeds of the Bonds and certain other funds of the City and the Board, and to certain other facts within the knowledge and control of the City and the Board; and such other documentation, including an examination of the Bonds executed and delivered initially by the City, which we found to be in due form and properly executed, and such matters of law as we deem relevant to the matters discussed below. In such examination, we have assumed the authenticity of all documents submitted to us as originals, the conformity to original copies of all documents submitted to us as certified copies, and the accuracy of the statements contained in such certificates. We express no opinion concerning any effect on the following opinions which may result from changes in law effected after the date hereof.

BASED ON OUR EXAMINATION, IT IS OUR OPINION that the Bonds have been duly authorized and issued in conformity with the laws of the State of Texas now in force and that the Bonds are valid and legally binding special obligations of the City enforceable in accordance with the terms and conditions described therein, except to the extent that the enforceability thereof may be affected by bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors' rights or the exercise of judicial discretion in accordance with general principles of equity. The Bonds are payable from and equally and ratably secured solely by a junior lien on and pledge of the Net Revenues (as defined in the Ordinance) derived from the operation of the Systems (as defined in the Ordinance), such lien on and pledge of the Net Revenues being expressly junior and inferior to the lien on and pledge of Net Revenues as security for the payment of the currently outstanding Senior Lien Obligations and any

Legal Opinion of Fulbright & Jaworski L.L.P. and Escamilla & Poneck, Inc. in connection with the authorization and issuance of "CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, SERIES 2003 "

Additional Senior Lien Obligations (each as defined in the Ordinance) hereafter issued by the City in accordance with the Ordinance. In the Ordinance, the City retains the right to issue Additional Senior Lien Obligations, Additional Junior Lien Obligations, Commercial Paper Obligations, and Inferior Lien Obligations (each as defined in the Ordinance), without limitation as to principal amount, but subject to the terms of the Ordinance and any terms, conditions, or restrictions as may be applicable thereto under law or otherwise. The Bonds do not constitute a legal or equitable pledge, charge, lien, or encumbrance upon any property of the City or the Board, except the Net Revenues. The holder of the Bonds shall never have the right to demand payment of the Bonds out of any funds raised or to be raised by taxation.

IT IS FURTHER OUR OPINION THAT, assuming continuing compliance after the date hereof by the City and the Board with the provisions of the Ordinance and in reliance upon the representations and certifications of the City and the Board made in a certificate of even date herewith pertaining to the use, expenditure, and investment of the proceeds of the Bonds, under existing statutes, regulations, published rulings, and court decisions (1) interest on the Bonds will be excludable from the gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date hereof (the *Code*), of the owners thereof for federal income tax purposes, pursuant to section 103 of the Code, except that we now express no opinion concerning any effect on such excludability of subsequent action which under the terms of the Ordinance may be taken only upon an opinion of counsel of nationally recognized standing in the field of municipal bond law that such action will not adversely affect such excludability, and (2) interest on the Bonds will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations.

WE CALL YOUR ATTENTION TO THE FACT THAT interest on all tax-exempt obligations, such as the Bonds, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a mutual fund, a financial asset securitization investment trust, a real estate mortgage investment conduit, or a real estate investment trust. A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code will be computed.

WE EXPRESS NO OPINION with respect to any other federal, state, or local tax consequences under present law or any proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, owners of an interest in a financial asset securitization investment trust, individual recipients of Social Security or Railroad Retirement Benefits, individuals otherwise qualifying for the earned income credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

The Ordinance provides that prior to taking certain actions the City must have received an opinion of bond counsel to the effect that such action will not adversely affect the exclusion from gross income for federal income tax purposes of the interest on the Bonds (an "Opinion of Bond Counsel"). We express no opinion currently as to the effect on the exclusion from gross income for federal income tax purposes of interest on the Bonds on and after the taking of any action under the Ordinance which requires that the City shall have received an Opinion of Bond Counsel.

APPENDIX E



CPS ENERGY

THE LIQUIDITY BANK

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THE LIQUIDITY BANK

Bank of America, N.A.

Bank of America, N.A. (the "*Bank*") is a national banking association organized under the laws of the United States, with its principal executive offices located in Charlotte, North Carolina. The Bank is a wholly-owned indirect subsidiary of Bank of America Corporation (the "*Corporation*") and is engaged in a general consumer banking, commercial banking and trust business, offering a wide range of commercial, corporate, international, financial market, retail and fiduciary banking services. As of March 31, 2007, the Bank had consolidated assets of \$1,204 billion, consolidated deposits of \$761 billion and stockholder's equity of \$109 billion based on regulatory accounting principles.

The Corporation is a bank holding company and a financial holding company, with its principal executive offices located in Charlotte, North Carolina. Additional information regarding the Corporation is set forth in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, together with any subsequent documents it filed with the Securities and Exchange Commission (the "*SEC*") pursuant to the Securities Exchange Act of 1934, as amended (the "*Exchange Act*").

Recent Developments: In April 2007, the Corporation announced an agreement to purchase ABN AMRO North America Holding Company, parent company of LaSalle Bank Corporation, from ABN AMRO Bank N.V (collectively, ABN AMRO) for \$21 billion in cash. The transaction has been approved by both company's boards of directors. On May 3, 2007, a court in the Netherlands ruled that ABN AMRO is enjoined from consummating the transaction until ABN AMRO's public shareholders vote on the proposed transaction. The Corporation has filed a lawsuit against ABN AMRO in a federal district court located in New York to enforce its legal rights.

Additional information regarding the foregoing is available from the filings made by the Corporation with the SEC, which filings can be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549, United States, at prescribed rates. In addition, the SEC maintains a website at <http://www.sec.gov>, which contains reports, proxy statements and other information regarding registrants that file such information electronically with the SEC.

The information concerning the Corporation, the Bank and the foregoing mergers contained herein is furnished solely to provide limited introductory information and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the documents and financial statements referenced herein.

Moody's Investors Service, Inc. ("*Moody's*") currently rates the Bank's long-term debt as "Aaa" and short-term debt as "P-1." The outlook is stable. Standard & Poor's rates the Bank's long-term debt as "AA+" and its short-term debt as "A-1+." The outlook is stable. Fitch Ratings, Inc. ("*Fitch*") rates long-term debt of the Bank as "AA" and short-term debt as "F1+." The outlook is stable. Further information with respect to such ratings may be obtained from Moody's, Standard & Poor's and Fitch, respectively. No assurances can be given that the current ratings of the Bank's instruments will be maintained.

The Bank will provide copies of the most recent Bank of America Corporation Annual Report on Form 10-K, any subsequent reports on Form 10-Q, and any required reports on Form 8-K (in each case as filed with the Commission pursuant to the Exchange Act), and the publicly available portions of the most recent quarterly Call Report of the Bank delivered to the Comptroller of the Currency, without charge, to each person to whom this document is delivered, on the written request of such person. Written requests should be directed to:

Bank of America Corporate Communications
100 North Tryon Street, 18th Floor
Charlotte, North Carolina 28255
Attention: Corporate Communications

PAYMENTS OF THE PURCHASE PRICE OF TENDERED BONDS, BUT NOT SCHEDULED PRINCIPAL OF AND INTEREST ON THE BONDS, MAY BE MADE FROM PURCHASES UNDER AND IN ACCORDANCE WITH THE STANDBY BOND PURCHASE AGREEMENT ARE NOT AVAILABLE. ALTHOUGH THE STANDBY BOND PURCHASE AGREEMENT IS A BINDING OBLIGATION OF THE BANK, THE BONDS ARE NOT DEPOSITS OR OBLIGATIONS OF THE CORPORATION OR ANY OF ITS AFFILIATED BANKS AND ARE NOT GUARANTEED BY ANY OF THESE ENTITIES. THE BONDS ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE

CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY AND ARE SUBJECT TO CERTAIN INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF THE PRINCIPAL AMOUNT INVESTED.

The delivery hereof shall not create any implication that there has been no change in the affairs of the Corporation or the Bank since the date hereof, or that the information contained or referred to in this Appendix is correct as of any time subsequent to its date.

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MUNICIPALLY OWNED ELECTRIC & GAS UTILITY
SAN ANTONIO, TEXAS 2007

**OFFERING MEMORANDUM
DATED: SEPTEMBER 7, 2007**

Ratings:
Fitch: F1+
Moody's: P-1
S&P: A-1+



**\$450,000,000
CITY OF SAN ANTONIO, TEXAS
ELECTRIC AND GAS SYSTEMS
COMMERCIAL PAPER NOTES, SERIES A**

**Liquidity facility provided by a
REVOLVING CREDIT AGREEMENT**

among

CITY OF SAN ANTONIO, TEXAS

**STATE STREET BANK AND TRUST COMPANY,
as Administrative Agent and a Bank**

and

**BANK OF AMERICA, N.A.,
as a Bank**

**Citigroup Global Markets Inc.,
as co-dealers**

**JPMorgan,
as co-dealers**

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OFFERING MEMORANDUM

**Relating To
\$450,000,000
CITY OF SAN ANTONIO, TEXAS
ELECTRIC AND GAS SYSTEMS
COMMERCIAL PAPER NOTES, SERIES A**

INTRODUCTORY STATEMENT

This Offering Memorandum, which includes the Appendices hereto, furnishes general information in connection with the issuance and sale of the captioned notes ("Notes"). The Notes were authorized by the City of San Antonio, Texas ("City") pursuant to an ordinance originally adopted and approved by the City Council of the City ("City Council") on October 20, 1988, and most recently amended and restated on June 26, 1997 ("Note Ordinance"). Capitalized terms used but not defined herein shall have the meanings set forth in the Note Ordinance and the Revolving Credit Agreement (hereinafter defined). Except where the context otherwise requires, words imparting the singular number shall include the plural number and vice versa. The City is authorized to issue the Notes in an aggregate principal amount not to exceed \$450,000,000 as of September 6, 2007 when the Revolving Credit Agreement was amended to increase the commitment amount from \$350,000,000 to \$450,000,000. The issuance of the Notes is further supported by the following agreements and involves the following related participants:

- Dealer Agreements with Citigroup Global Markets Inc. and J.P. Morgan Securities Inc.
- Revolving Credit Agreement ("Revolving Credit Agreement") with State Street Bank and Trust Company, as Administrative Agent and Lender, and Bank of America, N.A., as Lender.
- Issuing and Paying Agency Agreement with Deutsche Bank Trust Company Americas.

There follows in this Offering Memorandum a description of the electric and gas systems ("Systems") and its finances, the Notes and related provisions, and certain other applicable information. With respect to finances of the Systems, to view the audited financial statements of the City Public Service Board of San Antonio, Texas ("Board" or "CPS") for the fiscal years ending January 31, 2006 and 2007, please refer to APPENDIX C. All descriptions of documents contained herein are only summaries and are qualified in their entirety by reference to each such document.

THE INFORMATION AND EXPRESSIONS OF OPINION IN THIS OFFERING MEMORANDUM ARE SUBJECT TO CHANGE WITHOUT NOTICE AFTER SEPTEMBER 7, 2007, AND FUTURE USE OF THIS OFFERING MEMORANDUM SHALL NOT OTHERWISE CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE SINCE SEPTEMBER 7, 2007 IN THE MATTERS REFERRED TO IN THIS OFFERING MEMORANDUM. IN CONNECTION WITH THE INFORMATION DESCRIBED IN THE OFFERING MEMORANDUM, BOND COUNSEL REPRESENTS ONLY THE SYSTEMS.

THIS OFFERING MEMORANDUM DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE NOTES.

COMMERCIAL PAPER NOTES

Pursuant to authorization from the City, CPS maintains a Commercial Paper Program to provide tax-exempt financing for various purposes. The Commercial Paper Program, which has been amended numerous times since its inception in 1983, currently is authorized to have Notes outstanding thereunder in an amount not to exceed \$450,000,000. The Revolving Credit Agreement with a consortium of banks permits CPS to borrow up to an aggregate amount not to exceed \$450,000,000 for the purpose of paying amounts due under the Commercial Paper Program pursuant to an Amendment dated September 6, 2007. CPS may not have more than \$450,000,000 in aggregate principal amount of Notes outstanding unless the Revolving Credit Agreement is amended or a substitute agreement is entered into to provide liquidity for such increased amount. As of September 7, 2007, \$350,000,000 in aggregate principal amount of Notes was outstanding. Interest is calculated on the basis of actual days elapsed and a 365 day or 366-day year, as applicable.

The purpose of the Commercial Paper Program is (i) to assist in the financing of capital improvements to the Systems; (ii) to provide working capital and funds for fuel acquisition; (iii) to pay interest on resold Notes; (iv) to refund outstanding

Notes on maturity; and (v) to redeem other obligations of the Systems which are secured by and payable from a lien on and/or a pledge of Net Revenues of the Systems. Scheduled maturities of the Notes may not extend past November 1, 2028 (the "Maximum Maturity Date" in the Note Ordinance). See "RESPONSE TO COMPETITION – Debt and Asset Management Program" and "CONSTRUCTION PROGRAM" herein.

The borrowings under the Commercial Paper Program, including the Notes, are equally and ratably secured by and are payable from (i) the Net Revenues of the Systems, such pledge being subordinate and inferior to the pledge of Net Revenues securing the currently outstanding Senior Lien Obligations and Junior Lien Obligations and any Additional Senior Lien Obligations, Additional Junior Lien Obligations, or Prior Lien Bonds as each of these terms are defined in each of the Ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations; (ii) the proceeds from the sale of additional bonds issued for that purpose or borrowings under the Commercial Paper Program; and (iii) borrowings under and pursuant to the Revolving Credit Agreement. The obligations of the City under the Revolving Credit Agreement are secured on a parity basis with the pledge of the Net Revenues that secures the Notes that constitute the Commercial Paper Program. See "REVOLVING CREDIT AGREEMENT", herein.

Authority

The City is authorized, pursuant to Chapter 1371, Texas Government Code, as amended and the Note Ordinance, to issue the Notes in an aggregate principal amount not to exceed \$450,000,000 outstanding at any one time.

Security

The Notes are payable from and equally and ratably secured by a lien on and pledge of (i) the proceeds from (a) the sale of other Notes issued for such purpose and (b) the sale of a series or issue of Bonds (as defined in the Note Ordinance) to be issued by the City for such purpose, (ii) loans under and pursuant to the Revolving Credit Agreement (see below) among the City, State Street Bank and Trust Company, as Administrative Agent and Lender, and Bank of America, N.A., as Lender (collectively, the "Lenders") pursuant to which the Lenders have agreed to provide credit to the City under the terms and conditions set forth therein, which loans are to be evidenced by one or more Bank Notes (as defined in the Revolving Credit Agreement) provided, however, that the proceeds of loans may only be used to pay the principal of Notes, (iii) the amounts held in the Note Payment Fund (as defined in the Note Ordinance) until the amounts deposited therein are used for authorized purposes; provided, however, that amounts in the Note Payment Fund attributable to and derived from loans shall be used only to pay, prior to any application to the payment of the Bank Note (as defined in the Revolving Credit Agreement), the principal (but no redemption premium) of the Notes in full, and (iv) the amounts remaining on deposit in the Note Construction Fund (as defined in the Note Ordinance) after the payment of all Project Costs. To provide additional security for the payment of the principal and interest on the Notes, the Bank Notes, and other amounts due under the Revolving Credit Agreement as the same shall become due and payable, the Note Ordinance grants a lien on and pledge of the Net Revenues, however, being subordinate to the lien and pledge of the Net Revenues securing the payment of the currently outstanding Senior Lien Obligations and the Junior Lien Obligations and any Additional Senior Lien Obligations, Additional Junior Lien Obligations, and Prior Lien Bonds issued from time to time by the City. The City has the right to issue Additional Senior Lien Obligations, Additional Junior Lien Obligations, and Prior Lien Bonds without limitation as to principal amount that may be secured by a lien on and pledge of the Net Revenues superior to the lien securing the Notes.

The Notes do not constitute a general indebtedness of the City, of the Systems, the State of Texas, or any political subdivision of the State of Texas within the meaning of any constitutional, statutory, or charter provision or limitation. Neither the faith and credit nor the taxing power of the City, the State of Texas or any other political subdivision of the State is pledged to the payment of the Notes.

Perfection of Security for the Notes

Chapter 1208, as amended, Texas Government Code, applies to the issuance of the Notes and the pledge of the Net Revenues to secure the Notes, and such pledge is therefore, valid, effective and perfected. Should Texas law be amended while the Notes are outstanding and unpaid, the result of such amendment being that the pledge of the Net Revenues is to be subject to the filing requirements of Chapter 9, Texas Business and Commerce Code, in order to preserve to the registered owners of the Notes a security interest in such pledge, the City has agreed in the Note Ordinance to take such measures as it determines reasonable and necessary to enable a filing of a security interest in said pledge to occur.

Registered Owner's Remedies

If the City defaults in the payment of principal, interest, or redemption price on the Notes when due, or if it fails to make payments into any fund or funds created in the Ordinance, or defaults in the observation or performance of any other covenants, conditions, or obligations set for in the Ordinance, the registered owners may seek a writ of mandamus to compel City officials to carry out their legally imposed duties with respect to the Notes, if there is no other available remedy at law to compel performance of the Bonds or Ordinance and the City's obligations are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles, so rests with the discretion of the court, but may not be arbitrarily refused. There is no acceleration of maturity of the Notes in the event of default and, consequently, the remedy of mandamus may have to be relied upon from year to year. The Ordinance does not provide for the appointment of a trustee to represent the interest of the bondholders upon any failure of the City to perform in accordance with the terms of the Ordinance, or upon any other condition and accordingly all legal actions to enforce such remedies would have to be undertaken at the initiative of, and be financed by, the registered owners. On June 30, 2006, the Texas Supreme Court ruled in *Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006) that a waiver of sovereign immunity in a contractual dispute must be provided for by statute in "clear and unambiguous" language. Because it is unclear whether the Texas legislature has effectively waived the City's sovereign immunity from a suit for money damages, bondholders may not be able to bring such a suit against the City for breach of the Notes or the Ordinance covenants. Even if a judgment against the City could be obtained, it could not be enforced by direct levy and execution against the City's property. Furthermore, the City is eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues (such as the Net Revenues), such provision is subject to judicial construction. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or bondholders of an entity which has sought protection under Chapter 9. Therefore, should the City avail itself of Chapter 9 protection from creditors, the ability to enforce would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinion of Bond Counsel will note that all opinions relative to the enforceability of the Ordinance and the Notes are qualified with respect to the customary rights of debtors relative to their creditors.

DTC's Book-Entry System

The information in this section concerning The Depository Trust Company, New York, New York ("DTC"), and its book-entry system has been obtained from DTC. The City believes such information to be reliable, but the City takes no responsibility for the accuracy or completeness thereof.

The City cannot and does not give any assurance that (1) DTC will distribute payments of debt service on the Notes, or redemption or other notices, to DTC participants, (2) DTC participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Notes), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Offering Memorandum. The current rules applicable to DTC are on file with the Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries and territories that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial

relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC rules applicable to its participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC's records. The ownership interest of each actual purchaser of the Notes ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interest in the Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Principal and interest payments on the Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the City or the Issuing and Paying Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Issuing and Paying Agent or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Notes at any time by giving reasonable notice to the City. Under such circumstances, in the event that a successor depository is not obtained, Notes are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Notes will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

So long as Cede & Co. is the registered owner of the Notes, the City will have no obligation or responsibility to the DTC Participants or Indirect Participants, or the persons for which they act as nominees, with respect to payment to or providing of notice to such Participants, or the persons for which they act as nominees.

DESCRIPTION OF THE CITY

The City of San Antonio, Texas is a political subdivision and municipal corporation of the State of Texas, duly organized and existing under the laws of the State of Texas, including the City's home rule charter. The City was incorporated in 1837 and first adopted its Home Rule Charter in 1951. The City operates under a Council/Manager form of government with a city council comprised of the Mayor and ten Council members ("City Council"). The City Manager is the chief administrative officer for the City. The 2000 Census population for the City was approximately 1.15 million. The City covers approximately 521 square miles in south central Texas.

REVOLVING CREDIT AGREEMENT

The City entered into a Revolving Credit Agreement ("Revolving Credit Agreement") with State Street Bank and Trust Company, as Administrative Agent ("Administrative Agent") and Lender and Bank of America, N.A., as Lender (collectively, the "Lenders"), on November 1, 2004, as amended. Under the terms of the Revolving Credit Agreement, the City, provided it has satisfied certain conditions, may borrow up to \$450,000,000 in immediately available funds on a revolving basis, until November 1, 2012, with one-year extensions by mutual agreement of the City, the Administrative Agent and the Lenders, to pay the principal of maturing Notes. The Lenders agree to lend funds in the following amount:

- State Street Bank and Trust Company: \$225,000,000
- Bank of America, N.A.: \$225,000,000

The Revolving Credit Agreement and the Note Ordinance have been reviewed and approved by the Texas Attorney General.

The obligation of the Lenders to make any loan under the Revolving Credit Agreement is subject to receipt by the Administrative Agent of a written borrowing request and a determination that no Special Event of Default (as defined in the Revolving Credit Agreement) has occurred and is continuing. Special Events of Default include the following:

- 1) the City shall fail to pay any normally scheduled principal or interest due under the Bank Notes;
- 2) a final unappealable judgment or order for the payment of money in excess of \$20,000,000 payable from the Net Revenues shall be rendered against the Board or the City and such judgment or order shall continue unsatisfied and unstayed for a period of 60 days;
- 3) default by the City in the payment of any Bonds in excess of \$20,000,000 when due or within any applicable grace period;
- 4) the City shall commence a voluntary case or other proceeding seeking (i) liquidation, reorganization, or other relief with respect to the Systems or its Bonds under any bankruptcy, insolvency, or other similar law now or hereafter in effect or (ii) the appointment of a receiver, liquidator, custodian, or other similar official with respect to the City or any substantial part of its property, or shall consent to or acquiesce in such relief or the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it;
- 5) a receiver, liquidator, custodian, or other official, appointed in an involuntary case or proceeding commenced against the City, appointed without consent or acquiescence of the City, takes charge of a substantial part of the Systems and such action as to the Systems is not stayed, discharged, or vacated for a period of 90 days;
- 6) the City shall make a general assignment for the benefit of creditors, or declare a moratorium with respect to its Bonds, or shall fail generally to pay its Bonds as they become due, or shall take any action to authorize any of the foregoing;
- 7) an involuntary case or other proceeding shall be commenced against the City seeking (i) liquidation, reorganization, or other relief with respect to the City's Bonds under any bankruptcy, insolvency, or other similar law now or hereafter in effect, or (ii) the appointment of a custodian, receiver, liquidator, trustee or other similar official of the Systems, or any substantial part thereof, and such proceeding or case shall not be dismissed or stayed within 90 days after the filing thereof or an order of relief shall be entered against the City under the federal bankruptcy laws as now or hereafter in effect;

8) any provision of the Revolving Credit Agreement relating to the City's ability to make payments to the Administrative Agent, on behalf of the Lenders, to make payments on one or more of the Bank Notes or to raise funds to meet such payment obligations;

9) the powers of the City or the Board shall be limited in any way or the Note Ordinance shall be modified or amended in any way without the prior written consent of the Administrative Agent, in either case, which prevents the City or the Board from fixing, charging or collecting rates and charges for the use and services of the Systems in an amount sufficient to pay its Bonds as they become due; or

10) Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services, a Division of the McGraw-Hill Companies, Inc. ("S&P") shall have (i) assigned the Notes a rating below "F3" (Fitch), "P-3" (Moody's) and "A-3" (S&P), or (ii) assigned any Bonds a rating below "BBB"- (Fitch), "Baa3" (Moody's) and "BBB-" (S&P).

During the Revolving Credit Period, the City may, upon at least three Business Days' notice to the Administrative Agent and any Rating Agency which has issued a rating of the Notes, reduce from time to time by an aggregate amount of \$1,000,000 or any integral multiple of \$100,000 in excess thereof, the aggregate unused portion of the Commitment (as defined in the Revolving Credit Agreement) at the time provided that the City may not reduce the Commitment if the unused portion of the Commitment as proposed to be reduced would be less than the aggregate principal of all outstanding Notes.

Under the Revolving Credit Agreement, the Administrative Agent may deliver a notice (a "No-Issuance Notice") at any time that the Administrative Agent shall have determined that (a) a Default (as defined in the Revolving Credit Agreement) shall have occurred and be continuing; or (b) the representations and warranties of the City set forth in Article IV of the Revolving Credit Agreement are not true and correct in all material respects on and as of the date of the No-Issuance Notice. Upon receipt of a No-Issuance Notice the City must not issue any additional Notes unless and until the No-Issuance Notice is rescinded by the Administrative Agent in writing. Such No-Issuance Notice in and of itself will not render the Revolving Credit Agreement ineffective with respect to Notes outstanding prior to the instance of such No-Issuance Notice. **THE LENDERS ARE NOT REQUIRED TO MAKE ANY LOAN UNDER THE REVOLVING CREDIT AGREEMENT WITH RESPECT TO NOTES ISSUED IN VIOLATION OF A NO-ISSUANCE NOTICE.**

The City may not provide an Alternate Credit Facility unless the City shall have received written evidence from either Fitch, Moody's or S&P, that any outstanding ratings then assigned to the Notes by each agency will not be reduced or withdrawn as a result of the replacement or substitution of the Revolving Credit Agreement. The City will give the Issuing and Paying Agent at least 15 days written notice of any proposed substitution or replacement by the City of the Revolving Credit Agreement and, if applicable, the identity of the provider of any substituted amount or replaced Revolving Credit Agreement. Upon receipt of such notice, the Issuing and Paying Agent shall promptly give a copy of such notice to DTC and, if the Issuing and Paying Agent is provided with the names and addresses of the beneficial owners of the Notes, such beneficial owners of the Notes.

For information on the Lenders, refer to APPENDIX B.

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SAN ANTONIO ELECTRIC AND GAS SYSTEMS

History and Management

The City acquired its electric and gas utilities in 1942 from the American Light and Traction Company, which had been ordered by the federal government to sell properties under provisions of the Holding Company Act of 1935. The bond ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, Junior Lien Obligations and Commercial Paper Notes establish management requirements and provide that the complete management and control of the Systems is vested in the Board. The Mayor of the City is a voting member of the Board, represents the City Council, and is charged with the duty and responsibility of keeping the City Council fully advised and informed at all times of any actions, deliberations, and decisions of the Board and its conduct of the management of the Systems. The present members of the Board are:

<u>Name</u>	<u>Profession</u>	<u>Originally Appointed to the Board</u>	<u>Present Term Expires¹</u>
Stephen S. Hennigan, Chairman	Executive Vice President, San Antonio Federal Credit Union	June 1, 2001	January 31, 2011
Aurora Geis, Vice Chairman	Director, Fannie Mae San Antonio Partnership Office	March 28, 2002	January 31, 2012
Alvaro Sanchez, Jr., Trustee	United States Army, Retired Civil Service (US Air Force), Retired	March 4, 1999	January 31, 2009
Clayton T. Gay Jr., Trustee	Certified Public Accountant, Sole Proprietor	February 1, 1998	January 31, 2008
Phil Hardberger, Ex-Officio Member	Mayor, City of San Antonio	June 7, 2005	May 31, 2009

(1) Aurora Geis was reappointed to a second five-year term on November 20, 2006; Alvaro Sanchez, Jr., Clayton T. Gay Jr., and Stephen S. Hennigan are currently serving their second term. Mayor Phil Hardberger was re-elected on May 12, 2007 and accordingly is not eligible to serve as Mayor beyond his term that will expire on May 31, 2009.

Vacancies in membership on the Board are filled by majority vote of the remaining members. New Board appointees must be approved by a majority vote of the City Council. A vacancy in certain cases may be filled by the City Council. The members of the Board are eligible for re-appointment at the expiration of their first five-year term of office to one additional term. In 1997, the City Council ordained that Board membership should be representative of the geographic quadrants established by the City Council. New Board members considered for approval by the City Council will be those whose residence is in a quadrant that provides such geographic representation.

The Board is vested with all of the powers of the City with respect to the management and operation of the Systems and the expenditure and application of the revenues therefrom, including all powers necessary or appropriate for the performance of all covenants, undertakings, and agreements of the City contained in the bond ordinances, except regarding rates, condemnation proceedings, and issuance of bonds, notes, or commercial paper. The Board has full power and authority to make rules and regulations governing the furnishing of electric and gas service and full authority with reference to making extensions, improvements and additions to the Systems, and to adopt rules for the orderly handling of CPS' affairs. It is empowered to appoint and employ all officers and employees and must obtain and keep in force a "blanket" type employees' fidelity and indemnity bond covering losses in the amount of not less than \$100,000.

The management provisions of the bond ordinances also grant the City Council authority to review Board action with respect to policies adopted relating to research, development, and planning.

Citizens Advisory Committee

In 1997, CPS established a 15-member Citizens Advisory Committee ("CAC") to enhance its relationship with the community and to address the City Council's goals regarding broader community involvement with CPS. The CAC meets monthly and the primary goal of the CAC is to provide recommendations from the community on the operations of CPS for use by the Board and CPS staff. Representing the various sectors of CPS' service area, the CAC encompasses a broad range of customer groups in order to identify their concerns and understand their issues.

Administration and Operating Personnel

CPS had 3,789 employees as of January 31, 2007. The average tenure of a CPS employee is over 14 years. The vast majority of all executive and supervisory personnel have been schooled and trained in the utility industry. CPS employees have a broad range of benefits, including a defined benefit pension plan, group life insurance, hospitalization, major medical and other benefits. Generally good working conditions have produced a stable, well-qualified, highly motivated work force, which between February 1, 2006 and January 31, 2007 recorded an average turnover rate of 3.23%. There are approximately 1,902 hourly employees in the CPS work force and the International Brotherhood of Electrical Workers represents approximately 1,282 employees. As a municipal entity, these employees of CPS may not strike or collectively bargain with CPS; however, to foster an amenable working relationship with these employees, CPS management confers with representatives of these employees on matters pertaining to working conditions and wages.

CPS links an employee incentive compensation plan to employee participation in controlling expenses, promoting safety, maintaining low utility bills, attaining environmental goals, and enhancing customer satisfaction. The Executive Incentive Plan, established in 1997, provides links between CPS' competitiveness and each executive's compensation. Incentive plans were implemented for the entire salaried work force in 1998 and for the entire wage-scale (hourly) workforce in 2003.

CPS continues to enhance an executive Performance Management System implemented in the summer of 1998. A Performance Management System was implemented for salaried employees in June 2001. The Performance Management System established a process that develops and emphasizes facilitative leadership, and engages all employees in actively working toward key shared organizational and business unit strategies and objectives. The process is designed to provide for continual monitoring and a high level of coaching and feedback to reach performance expectations, to provide meaningful developmental opportunities, to emphasize how results are achieved, and to reward and recognize contributions toward business goals. The traditional employee annual review process and cost-of-living driven pay system have been replaced with an enhanced performance assessment process, market-based salaries, and incentive awards based on CPS' overall performance. In addition, CPS is actively engaged in comprehensive Workforce Development and Succession Planning processes to promote wider development opportunity for all employees to learn and grow. These processes are based on the foundational ideas that all employees are expected to develop to their maximum capabilities and that succession planning must focus on ensuring that key positions in the organization are always staffed by employees who have the capacity to keep the company operating at its highest level of productivity.

In the fall of 2006, CPS announced plans for a major organizational redesign of CPS' management. This redesign is focused on preparing CPS for the competitive deregulated market that it may be required to enter in the future. By developing an optimal management structure, CPS wants to ensure its continued success in the competitive deregulated environment. The first phase of the organizational redesign plan began on November 21, 2006. CPS announced the creation of a senior management "Strategy Development Team". The goal of this management team is to concentrate on corporate strategies for CPS' continued success. Reporting directly to the Strategy Development Team is a management team that will focus on strategy implementation. The "Strategy Implementation Team" will concentrate on transforming strategic plans into operational processes and actions. Phase one of the redesign was completed with the selection of the members to the Strategy Implementation Team on February 7, 2007. Phase two of the organizational redesign has begun and will focus on the development of CPS' lower level management and supervisory positions. This second phase is scheduled to be completed in September 2007.

CPS' principal executives and members of the Strategy Development Team are as follows: Milton B. Lee, General Manager and CEO; Richard E. Williamson, Executive Vice President, Chief Financial Officer and Treasurer; Alfonso R. Lujan, Executive Vice President for Energy Delivery and Solutions; Michael K. Kotara, Executive Vice President for Energy Development; Stephen L. Bartley, Executive Vice President for Strategy and External Relations, Carolyn E. Shellman, Senior Vice President and General Counsel, Paula Gold-Williams, Vice President and Chief Administrative Officer, and Christopher C. Barron, Vice President and Chief Information Officer.

Mr. Lee has been an employee of CPS since July 2000. During his 31 years of utility experience prior to joining CPS, he served with the Public Utility Commission of Texas, the City of Austin as General Manager of Austin's electric utility, and the Lower Colorado River Authority, prior to becoming Senior Vice President for Electric Transmission and Distribution Systems at CPS. He was appointed the General Manager and CEO for CPS on January 28, 2002.

Mr. Williamson has been an employee of CPS since 1970 and he has served as Supervisor of Budget Administration, Supervisor of Financial Reporting and Analysis, Supervisor of Cash Management, Supervisor of Financial Management and Treasury Programs, Supervisor of Investment and Trust Analysis, Director of Finance, Vice President of Financial Services and Senior Vice President of Financial Services and Chief Financial Officer, prior to his current position as Executive Vice President and Chief Financial Officer. Mr. Williamson is responsible for the budgeting, finance, accounting, risk management, and the financial operations of CPS. Mr. Williamson also serves as Treasurer for the Board.

Mr. Lujan joined CPS in September 2003 as Senior Vice President for Energy Delivery Services and he currently holds the position of Executive Vice President for Energy Delivery and Solutions. During his 35 years in the utility industry, he served as Vice President of Electric Service Delivery at Public Service Company of New Mexico and Senior Vice President of Electric Service Delivery, as well as Chief Operating Officer of the City of Austin's electric utility. Mr. Lujan is responsible for CPS' energy delivery services, engineering services, operations support, operations and maintenance, planning and reliability, retail operations and strategic marketing.

Mr. Kotara has been an employee of CPS since 1985, and has held several leadership positions including Director of Gas Engineering, Director of Marketing, Director of Generation Control & Marketing, Director of Fuels, Vice President of the Gas Business Unit, and Vice President of Wholesale Energy Markets. In his current role as Executive Vice President of Energy Development, Mr. Kotara is responsible for all aspects of power generation including engineering, operations, maintenance, construction and nuclear generation oversight as well as generation planning, wholesale energy market operations and marketing, fuels supply, fuels hedging and environmental services.

Mr. Bartley joined CPS in September 2000 and has served as Director of Governmental Relations and Vice President of Governmental and Regulatory Relations prior to his current position as Executive Vice President for Strategy and External Relations. During his 29 years in the utility industry, he has held several senior management positions for the Lower Colorado River Authority and Austin Energy. As the Executive Vice President for Strategy and External Relations, he is responsible for CPS' business strategy process, community relations, corporate communications, governmental relations and regulatory relations.

Ms. Shellman joined CPS in July 2006. Ms. Shellman comes to CPS with over 25 years as an attorney in the utility industry. She previously served as General Counsel and Secretary for the Electric Reliability Council of Texas ("ERCOT"). Prior to that she served as a partner in the utility sections of two separate Texas law firms. Ms. Shellman has also served as the Director for the Hearings Section of the Public Utility Commission of Texas ("PUCT") and as a hearing officer with the PUCT. As CPS' General Counsel she focuses on state and federal laws and regulations affecting CPS.

Ms. Gold-Williams joined CPS in October 2004 and has served as Controller prior to her current position as Vice President and Chief Administrative Officer. Ms. Gold-Williams is responsible for the major areas of human resources, supply chain and facilities. Prior to joining CPS, she held several senior management positions at other companies.

Mr. Barron joined CPS in November 2004 and has served as Director of Information Technology Services and Director of Enterprise Applications and E-Commerce prior to his current position as Vice President and Chief Information Officer. During his 17 years in information technology, Mr. Barron has headed a global consulting services company and has been an executive with a Fortune 100 company. Mr. Barron is responsible for CPS' IT department which includes enterprise applications, e-commerce, communications, program management, IT infrastructure, and information security.

Service Area

The CPS electric system serves a territory consisting of substantially all of Bexar County and small portions of the adjacent counties of Comal, Guadalupe, Atascosa, Medina, Bandera, Wilson and Kendall. Certification of this service area has been approved by the PUCT.

CPS is currently the exclusive provider of electric service within this service area, including the provision of electric service to some Federal military installations located within the service area that own their own distribution facilities. As discussed below under "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7", until and unless the San Antonio City Council and the Board exercise the option to opt-in to retail electric competition (called "Texas Electric Choice" by the PUCT), CPS has the sole right to provide retail electric services in its service area. On April 26, 2001, after a thorough feasibility study was conducted and reviewed, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002, the date Texas Electric Choice became effective. Senate Bill 7 ("SB 7"), adopted by the Texas Legislature in 1999, provides that electric "opt-in" decisions are to be made by the governing body or the body vested with the power to manage and operate a municipal utility such as CPS. Given the relationship of the Board and the City Council, any decision to opt-in to electric competition would be based upon the adoption of resolutions of both the Board and the City Council. If the City and CPS choose to opt-in, other retail electric energy suppliers would be authorized to offer retail electric energy in the CPS service area and CPS would be authorized to offer retail electric energy in any other service areas open to retail competition in ERCOT. ERCOT is the independent entity that monitors and administers the flow of electricity within the interconnected grid that operates wholly within Texas. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Interconnected System" and "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments". CPS has the option of acting in the role of the "Provider of Last Resort" (hereinafter defined)

for its service area in the event it and the City choose to opt-in. See “CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7” herein.

In addition to the area served at retail rates, CPS sells wholesale electricity to the Floresville Electric Light & Power System, the City of Hondo, and the City of Castroville. These three wholesale supply agreements have remaining terms ranging from less than one to ten years until expiration, although all of the agreements provide for extensions. Discussions are ongoing with all three entities to renew their respective long-term wholesale power agreements. Additionally, CPS has recently entered into several one-year wholesale supply agreements with other various municipalities and cooperatives. CPS will seek additional opportunities to enter into long-term wholesale electric power agreements in the future. The requirements under the existing and any new wholesale agreements would be firm energy obligations of CPS.

The CPS gas system serves the City and its environs, although there is no certificated CPS gas service area. In Texas, no legislative provision or regulatory procedure exists for certification of natural gas service areas. As a result, CPS competes against other gas supplying entities on the periphery of its service area. Pursuant to the authority provided by Section 181.026, Texas Utilities Code, among other applicable laws, the City has executed a license agreement (“License Agreement”) with the City of Grey Forest, Texas (“Licensee”), dated as July 28, 2003, for a term through May 31, 2028. Pursuant to this License Agreement, the City permits the Licensee to provide, construct, operate and maintain certain natural gas lines within the boundaries of the City which it originally established in 1967 and to provide extensions and other improvements thereto upon compliance with the provisions of the License Agreement and upon the payment to the City of a quarterly license fee of 3.0% of the gross revenues received by the Licensee from the sale of natural gas within the Licensed Area (as defined in the License Agreement). Thus, in the Licensed Area, CPS is in direct competition with Grey Forest Utilities as a supplier of natural gas.

CPS also has 20-year Franchise Agreements with 28 incorporated communities in the San Antonio area. These Franchise Agreements permit CPS to operate its facilities in the city’s streets and public ways in exchange for a franchise fee of 3.0% on electric and natural gas revenues earned within their respective municipal boundaries. Of these 28 agreements, 24 expire in 2010; the others expire in 2011, 2017, 2023 and 2024.

Customer Base

Electric ¹			Gas ¹		
	Number	Percent		Number	Percent
Residential	580,208	87%	Residential	293,803	93%
Commercial & Industrial	63,085	10%	Commercial	18,358	6%
All Night Security Lighting	11,070	2%	Industrial & Public	2,624	1%
Street Lighting, Public Authorities & Other Utilities ²	7,768	1%			
Total	662,131	100%	Total	314,785	100%

(1) At January 31, 2007. See “FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY” and “FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE” for information regarding consumption of energy and contribution of revenues to the Systems by the average customer for these categories.

(2) Also includes off-system sales customers.

Retail Service Rates

Under the Texas Public Utility Regulatory Act (“PURA”), significant original jurisdiction over the rates, services, and operations of “electric utilities” is vested in the PUCT. In this context, “electric utility” means an electric investor-owned utility. Since the electric deregulation aspects of SB 7 became effective on January 1, 2002, the PUCT’s jurisdiction over electric investor-owned utility (“IOU”) companies primarily encompasses only the transmission and distribution functions. PURA generally excludes municipally-owned utilities (“Municipal Utilities”), such as CPS, from PUCT jurisdiction, although the PUCT has jurisdiction over electric wholesale transmission rates. See “Transmission Access and Rate Regulation” herein. Under the PURA, a municipal governing body or the body vested with the power to manage and operate a Municipal Utility such as CPS has exclusive jurisdiction to set rates applicable to all services provided by the Municipal Utility with the exception of electric wholesale transmission activities and rates. Unless and until the City Council and Board choose to opt-in to electric retail competition, CPS retail service electric rates are subject to appellate, but not original rate regulatory jurisdiction by the PUCT in areas that CPS serves outside the San Antonio City limits. To date, no such appeal to the PUCT of CPS retail electric rates has ever been filed. CPS is not subject to the annual PUCT

gross receipts fee payable by electric utilities. See "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7" herein.

The Texas Railroad Commission ("TRC") has significant original jurisdiction over the rates, services and operations of all natural gas utilities in the State. Municipal Utilities such as CPS are generally excluded from regulation by the TRC, except in matters related to natural gas safety. CPS retail gas service rates applicable to rate payers outside San Antonio are subject to appellate, but not original rate regulatory jurisdiction, by the TRC in areas that CPS serves outside the City limits. To date, no such appeal to the TRC of CPS retail gas rates has ever been filed. In the absence of a contract for service, the TRC also has jurisdiction to establish gas transportation rates for service to Texas State Agencies by a Municipal Utility. A Municipal Utility is also required to sell gas to and transport State-owned gas for "public retail customers," including State agencies, State institutions of higher education, public school districts, U.S. military installations, and U.S. Veterans Affairs facilities, at rates provided by written contract between the Municipal Utility and the buyer entity. If agreement to such a contract cannot be reached, a rate would be set by the legal and relevant regulatory body.

The City has covenanted and is obligated under the bond ordinances, as provided under the rate covenant, to establish and maintain rates and collect charges in an amount sufficient to pay all maintenance and operating expenses of the Systems and to pay the debt service requirements on all revenue debt of the Systems, including the outstanding Previously Issued Parity Bonds, the Bonds, any Additional Senior Lien Obligations, the currently outstanding Junior Lien Obligations, Liquidity Facility obligations, any Additional Junior Lien Obligations, the Notes and Inferior Lien Obligations, and to make all other payments prescribed in the bond ordinances.

Rate changes over the past 16 years have consisted of a 4.0% combined electric and gas base rate increase effective January 31, 1991; a new Large Volume Gas rate effective July 31, 1992, which was offered to Large Gas Customers whose monthly gas usage exceeded 550 MCF per month and enabled them to reduce bills by approximately 8.8%; a Super Large Power ("SLP") electric rate effective January 4, 1994, which reduced the basic rates to customers having loads greater than 5,000 KW per month and annual load factors greater than 41% by approximately 10.1%; a 3.5% electric base rate adjustment effective May 19, 2005, and a 12.1% gas base rate adjustment effective June 26, 2006. The 2005 electric rate adjustment was intended to offset the incremental costs to be incurred due to acquiring an additional 12.0% share in the STP. This acquisition was completed in May 2005. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - South Texas Project" herein. CPS projects that the net effect of the base rate adjustment and fuel cost savings from additional nuclear-fueled generation will result in lower overall bills for CPS' electric customers. CPS also offers a monthly contract for renewable energy service (currently this is wind-generated electricity) under Rider E15, which became effective May 2000. The rate for Rider E15 was reduced to its current level effective on September 30, 2002. A rider to the SLP rate, the Economic Incentive Rider E16, became effective March 10, 2003, and offers discounts off the SLP demand charge for a period up to four years for new or added load of at least 10 megawatts ("MW"). Under certain conditions, the discount may be extended an additional three years. Customers that choose Economic Incentive Rider E16 must also meet City employment targets and targets for purchases of goods or services from local businesses in order to qualify. CPS also has rates that permit recovery of certain miscellaneous customer charges and for extending lines to provide gas and electric service to its customers. In May 2005, the Board adopted a change to its policies for both miscellaneous customer charges and line extensions, which became effective January 1, 2006, to increase charges that had not been raised since 1986. On December 15, 2005, the City Council adopted Ordinance Nos. 101819 and 101820 approving certain of the price changes in the CPS Board-approved policy; however, the City ordinances prevent recovery of increased line extension charges from developers of affordable housing and the City delayed implementation of certain miscellaneous customer charges until April 1, 2006 (fees for disconnection, reconnection and field notification).

Each of CPS' retail and wholesale rates contains an electric fuel adjustment or gas cost adjustment clause, which provides for current recovery of fuel costs. The fuel cost recovery adjustments are set at the beginning of each CPS billing cycle month. See "CUSTOMER RATES – Fuel and Gas Cost Adjustment" herein.

Transmission Access and Rate Regulation

Pursuant to amendments made by the Texas Legislature in 1995 to the PURA ("PURA95"), Municipal Utilities, including CPS, became subject to the regulatory jurisdiction of the PUCT for transmission of wholesale energy. PURA95 requires the PUCT to establish open access transmission on the interconnected Texas grid for all utilities, co-generators, power marketers, independent power producers and other transmission customers.

The 1999 Texas Legislature amended the PURA95 to expressly authorize rate authority over Municipal Utilities for wholesale transmission and to require that the postage stamp method be used exclusively for pricing wholesale transmission transactions. The PUCT in late 1999 amended its transmission rule to incorporate fully the postage stamp pricing method which sets the price for transmission at the system average for ERCOT. CPS' wholesale open access

transmission charges are set out in tariffs filed at the PUCT, and are based on its transmission cost of service approved by the PUCT, representing CPS' input to the calculation of the statewide postage stamp pricing method. The PUCT's rule, consistent with provisions in PURA §35.005(b), also provides that the PUCT may require construction or enlargement of transmission facilities in order to facilitate wholesale transmission service. Pursuant to P.U.C. Docket No. 31540, "Proceeding to Consider Protocols to Implement a Nodal Market in the Electric Reliability Council of Texas Pursuant SUBST. R. 25.501", the PUCT has made substantial progress in evaluating the shift from postage stamp pricing to nodal pricing for transmission transactions. Until the PUCT takes final action on nodal pricing, it will not be possible to predict the effects on CPS' transmission costs or its ability to recover costs from other participants in ERCOT. Additional information on recovery of ERCOT transmission fees is discussed in "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments" and with respect to the transition to the nodal market is discussed in "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Post Senate Bill 7 Wholesale Market Design Developments" herein.

CUSTOMER RATES

CPS' electric and gas monthly rate schedules list the currently effective monthly charges payable by CPS customers. Each rate schedule briefly describes the types of service CPS renders to customers billed in accordance with that rate schedule, plus customer eligibility criteria. Customers with similar load and usage characteristics are grouped into rate classes and are billed in accordance with the same rate schedule. The different electric rate classes include rate schedules for residential, commercial, and industrial customers. There are also rate schedules for street lighting, other utilities and all night security lights. The gas rate schedules are categorized into general, commercial and industrial.

Fuel and Gas Cost Adjustment

The rates feature a fuel cost adjustment provision in the electric rates and a gas adjustment provision in the gas rates which allow CPS to reconcile fuel and gas cost variances above or below base fuel levels included in base rates. CPS' electric rates are subject to a positive or negative adjustment equal to the variance in the price of fuel above or below a base cost of \$0.01416 per kWh. Similarly, CPS' base gas rates are subject to an adjustment equal to the variance in the price of fuel above or below a base cost of \$0.220 per CCF (100 cubic feet).

Governmentally Imposed Fees, Taxes or Payments

The rates, as previously approved by various rate ordinances adopted by the City Council, may be adjusted without further action by the City Council to reflect the increase or decrease of fees, taxes or other required payments to governmental entities or for governmental or municipal purposes which may be hereafter assessed, imposed, or otherwise required and which are payable out of or are based upon Net Revenues of the Systems.

In March 2000, two new governmental assessments resulting from regulatory changes in the Texas electric utility industry, including the open access wholesale transmission charges, were added to CPS' electric billings as regulatory adjustments and will be updated annually or as needed. The first assessment recovers additional ERCOT-related transmission expenditures not recovered through CPS' current base rates. For residential CPS customer rates, this adjustment (effective September 2006) currently adds an additional \$0.00154 per kWh sold. The second assessment relates to CPS' share of the cost to fund the staffing and operation of the Independent System Operator ("ISO") for ERCOT, the implementation of the nodal market within ERCOT, as well as other market-related costs due to congestion and voltage reliability issues. The PUCT retains oversight authority over ERCOT. For residential CPS customers, this charge increases bills by an additional \$0.00059 per kWh sold.

In March 2005, the Texas Railroad Commission began imposing a regulatory fee to cover the cost of regulation by the Texas Railroad Commission. The fee is based upon the number of active gas customers and is recovered from CPS gas customers through the payment of a one time annual fee.

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TEN-YEAR ELECTRIC CUSTOMER STATISTICS¹

	Fiscal Year Ended January 31,									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
RESIDENTIAL										
Average Monthly KWH/ Customer	1,059	1,140	1,104	1,190	1,141	1,154	1,174	1,159	1,217	1,247
Average Monthly Bill/ Customer	\$69.49	\$74.37	\$72.84	\$85.55	\$77.53	\$81.54	\$94.06	\$87.39	\$99.59	\$98.27
Average Monthly Revenue/KWH	\$0.0656	\$0.0652	\$0.0660	\$0.0719	\$0.0679	\$0.0707	\$0.0801	\$0.0754	\$0.0818	\$0.0788
COMMERCIAL AND INDUSTRIAL										
Average Monthly KWH/ Customer	10,603	10,966	10,874	11,145	11,116	11,334	12,174	11,345	11,187	11,036
Average Monthly Bill/ Customer	\$539.73	\$550.73	\$554.06	\$629.98	\$594.33	\$631.54	\$790.31	\$691.48	\$754.65	\$710.85
Average Monthly Revenue/KWH	\$0.0509	\$0.0502	\$0.0510	\$0.0565	\$0.0535	\$0.0557	\$0.0649	\$0.0609	\$0.0675	\$0.0644
ALL CUSTOMERS										
Average Monthly KWH/ Customer	2,303	2,425	2,383	2,475	2,404	2,434	2,440	2,401	2,471	2,499
Average Monthly Bill/ Customer	\$129.42	\$135.12	\$134.50	\$154.65	\$142.08	\$151.31	\$173.82	\$159.88	\$180.27	\$174.92
Average Monthly Revenue/KWH	\$0.0562	\$0.0557	\$0.0564	\$0.0625	\$0.0591	\$0.0622	\$0.0712	\$0.0666	\$0.0730	\$0.0700

(1) Excludes unbilled revenues.

HISTORICAL RECORD OF CITY OF SAN ANTONIO GENERAL FUND BENEFITS FROM CITY'S ELECTRIC AND GAS UTILITY SYSTEMS (Dollars in Thousands)

	Fiscal Years Ended January 31,									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Payments										
To City ¹	\$ 138,543	\$ 144,555	\$ 145,474	\$ 185,006	\$ 168,135	\$ 172,235	\$ 206,057	\$ 194,901	\$ 227,178	\$ 235,898

(1) Payments to the City, by ordinance, are not to exceed 14% of CPS' gross revenue, include cash payments and refund of charges for furnishing the City electricity and gas services, and for a street light replacement program.

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FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY

	Fiscal Year Ended January 31,				
	2003	2004	2005	2006	2007
ELECTRIC SYSTEM					
SALES IN KWH¹					
Residential	7,248,869,894	7,380,490,515	7,449,673,383	8,052,142,783	8,546,981,548
Commercial & industrial	7,732,905,220	8,485,624,162	8,024,602,819	8,074,456,666	8,264,544,798
Street lighting	77,694,161	79,634,339	79,423,113	81,014,821	91,350,091
Public authorities	1,829,765,716	1,100,521,486	1,633,005,953	1,965,844,597	2,218,197,824
Other utilities	502,552,040	1,195,537,532	1,622,928,313	1,849,949,855	2,958,437,090
ANSL ²	19,358,876	19,822,990	20,137,010	20,850,505	21,199,115
Total sales in KWH	<u>17,411,145,907</u>	<u>18,261,631,024</u>	<u>18,829,770,591</u>	<u>20,044,259,227</u>	<u>22,100,710,466</u>
AVERAGE NUMBER OF CUSTOMERS					
Residential	523,424	524,108	535,784	551,355	571,148
Commercial & industrial	56,855	58,086	58,943	60,145	62,407
Street lighting	115	147	198	422	2,320
Public authorities	5,375	5,442	6,471	6,293	5,628
Other utilities	13	14	19	20	18
ANSL ²	10,239	10,303	10,445	10,725	10,953
Total customers	<u>596,021</u>	<u>598,100</u>	<u>611,860</u>	<u>628,960</u>	<u>652,474</u>
KWH SALES PER CUSTOMER					
Residential	13,849	14,082	13,904	14,604	14,964
Commercial & industrial	136,011	146,087	136,142	134,250	132,430
GAS SYSTEM					
SALES IN MCF¹					
Residential	12,088,082	11,215,488	10,607,280	9,794,730	9,474,163
Commercial	8,888,993	8,872,513	8,595,134	8,420,965	8,719,182
Industrial	1,494,910	1,278,389	1,175,241	1,184,875	1,095,727
Public authorities	1,785,520	1,800,675	2,026,390	2,258,826	2,081,997
Total sales in MCF	<u>24,257,505</u>	<u>23,167,065</u>	<u>22,404,045</u>	<u>21,659,396</u>	<u>21,371,069</u>
AVERAGE NUMBER OF CUSTOMERS					
Residential	286,006	285,241	287,096	288,898	292,083
Commercial	18,536	18,795	18,758	18,411	18,237
Industrial	99	93	87	80	76
Public authorities	2,079	2,216	2,334	2,373	2,540
Total customers	<u>306,720</u>	<u>306,345</u>	<u>308,275</u>	<u>309,762</u>	<u>312,936</u>
MCF SALES PER CUSTOMER					
Residential	42	39	37	34	32
Commercial	480	472	458	457	478
Industrial	15,100	13,746	13,509	14,811	14,417

(1) Excludes unbilled revenues and sales.

(2) All Night Security Lighting.

FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE¹

	Fiscal Year Ended January 31,				
	2003	2004	2005	2006	2007
ELECTRIC SYSTEM					
BILLED REVENUES					
Residential	\$512,164,406	\$591,592,883	\$561,876,727	\$658,916,783	\$673,553,856
Commercial & industrial	430,872,999	550,872,351	489,091,773	544,660,000	532,343,750
Street lighting	8,431,030	11,007,177	10,724,868	11,414,666	11,314,041
Public authorities	95,842,688	70,965,854	89,671,069	117,661,362	127,237,302
Other utilities	30,209,384	47,755,523	67,096,105	107,656,944	145,115,015
ANSL ²	4,659,021	3,029,184	2,810,373	3,298,367	3,254,248
Other	9,900,798	14,932,968	23,660,332	15,951,021	13,751,476
Total revenues	<u>1,092,080,326</u>	<u>1,290,155,940</u>	<u>1,244,931,247</u>	<u>1,459,559,143</u>	<u>1,506,569,688</u>
OPERATION & MAINTENANCE EXPENSE					
Production	312,328,375	436,648,229	392,918,275	499,098,803	531,000,491
Transmission	9,298,516	10,981,566	11,828,869	12,029,652	16,441,817
Distribution	50,798,655	53,739,899	62,775,897	61,000,014	74,886,837
Regulatory assessments	22,294,418	45,850,991	42,075,814	37,083,246	28,644,959
Customer accounts	13,187,147	13,542,047	15,550,798	18,673,088	22,523,086
Customer information	1,662,252	1,308,208	976,222	1,436,331	791,074
Administrative & general	102,486,169	97,414,525	80,498,588	77,595,068	58,947,387
Payroll taxes	8,638,622	8,448,062	8,138,567	7,496,083	4,651,131
STP decommissioning expense	15,189,000	15,189,000	6,328,750	4,380,000	4,380,000
STP operating & maintenance expense	82,727,552	96,446,032	96,014,075	131,601,697	149,100,712
Total expenses	<u>618,610,706</u>	<u>779,568,559</u>	<u>717,105,855</u>	<u>850,393,982</u>	<u>891,367,494</u>
Operating income - electric	<u>473,469,620</u>	<u>510,587,381</u>	<u>527,825,392</u>	<u>609,165,161</u>	<u>615,202,194</u>
GAS SYSTEM					
BILLED REVENUES					
Residential	84,616,216	112,683,034	105,158,123	119,685,785	120,927,007
Commercial & industrial	55,476,154	82,988,207	79,393,303	102,757,554	99,297,749
Public authorities	9,122,495	13,978,202	15,521,605	21,707,539	19,766,696
Other	1,813,411	1,204,893	1,264,134	1,153,715	1,144,716
Total revenues	<u>151,028,276</u>	<u>210,854,336</u>	<u>201,337,165</u>	<u>245,304,593</u>	<u>241,136,168</u>
OPERATION & MAINTENANCE EXPENSE					
Gas purchased	90,955,067	131,631,165	133,966,032	170,893,663	174,793,863
Distribution	12,071,625	13,483,883	14,179,683	16,648,494	18,694,494
Customer accounts	6,480,485	6,654,891	7,659,348	9,197,192	11,093,460
Customer information	557,340	438,632	325,407	478,777	263,691
Administrative & general	9,912,117	9,427,835	8,055,949	8,302,787	6,219,420
Payroll taxes	1,573,754	1,265,704	1,216,108	1,120,105	694,997
Total expenses	<u>121,550,388</u>	<u>162,902,110</u>	<u>165,402,527</u>	<u>206,641,018</u>	<u>211,759,925</u>
Operating income - gas	<u>29,477,888</u>	<u>47,952,226</u>	<u>35,934,638</u>	<u>38,663,575</u>	<u>29,376,243</u>
Combined operating income- Electric and gas	502,947,508	558,539,607	563,760,030	647,828,736	644,578,437
Nonoperating income	28,547,471	25,893,513	26,986,005	50,063,264	74,524,014
NET REVENUES, per ordinances	<u>\$531,494,979</u>	<u>\$584,433,120</u>	<u>\$590,746,035</u>	<u>\$697,892,000</u>	<u>\$719,102,451</u>
DEBT SERVICE					
Senior lien obligations - Principal and interest	\$211,830,818	\$230,249,667	\$245,984,372	\$256,442,059	\$271,931,037
Junior lien obligations - interest	0	2,111,053	4,386,011	10,964,118	15,005,843
Interest on commercial paper	5,327,359	4,125,319	5,125,135	7,693,133	8,503,062
TOTAL DEBT SERVICE	<u>\$217,158,177</u>	<u>\$236,486,039</u>	<u>\$255,495,518</u>	<u>\$275,099,311</u>	<u>\$295,439,942</u>
DEBT SERVICE COVERAGE					
Senior & junior lien obligations and commercial paper	2.45x	2.47x	2.31x	2.54x	2.43x
Senior lien obligations	2.51x	2.54x	2.40x	2.72x	2.64x

(1) Excludes component units.

(2) All Night Security Lighting.

FORWARD-LOOKING STATEMENTS

This Official Statement, including the Appendices hereto, contains forward-looking statements within the meaning of the federal securities laws. Such statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the power utility industry and general economic conditions. Such words as expects, intends, plans, believes, estimates, anticipates or variations of such words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. Actual results may vary materially from what is contained in a forward-looking statement. Factors which may cause a result different from those expected or anticipated include, among other things, new legislation, increases in suppliers' prices, particularly prices for fuel in connection with the operation of the Systems, changes in environmental compliance requirements, acquisitions, changes in customer power use patterns, natural disasters and the impact of weather on operating results.

Although CPS believes in making any such forward-looking statement, its expectations are based on reasonable assumptions, any such forward-looking statement involves uncertainties and is qualified in its entirety by reference to factors both identified within this Official Statement and from publicly available resources about the electric and gas businesses, regulation and regulatory authorities for that business, and the City that could cause the actual results of CPS to differ materially from those contemplated in such forward-looking statements.

Any forward-looking statement speaks only as of the date on which such statement is made, and CPS undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for CPS to predict all of such factors, nor can it assess the impact of each such factor or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

MANAGEMENT DISCUSSION

CPS' audited financial statements for the fiscal years ended January 31, 2007 and 2006, and the Independent Auditors' report thereon are in APPENDIX B. As described herein, CPS adopted Statement No. 34 of the Governmental Accounting Standards Board ("GASB") during its fiscal year ended January 31, 2002, which required the preparation of a Management Discussion and Analysis ("MD&A") in connection with the annual financial report of CPS. Reference is hereby made to APPENDIX B for the MD&A pertaining to the CPS fiscal year ended January 31, 2007.

The operating results of the Systems reflect the results of past operations and are not necessarily indicative of results of operations for any future period. Future operations will be affected by factors relating to changes in rates, fuel and other operating costs, utility industry regulation and deregulation, environmental regulation, economic growth of the community, population, weather, and other matters; the nature and effect of which cannot at present be determined. See "FORWARD-LOOKING STATEMENTS" herein.

IMPLEMENTATION OF NEW ACCOUNTING POLICIES

For the fiscal year ended January 31, 2007, CPS implemented:

- GASB Statement No. 43, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*. The statement establishes uniform standards of financial reporting for other Post-Employment benefit plans. The statement establishes disclosure requirements for both the employee benefit plans and employer financial statements. Disclosure requirements for the employer have been incorporated into Appendix B, Note 9 – Employee and Other Post-Employment Benefits.
- GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Provisions of Medicare Part D*. The technical bulletin clarifies the application of existing standards of accounting and financial reporting to payments received by an employer or its OPEB plan from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. Disclosure requirements for the employer have been incorporated into Appendix B, Note 9 – Employee and Other Post-Employment Benefits.

Other than the aforementioned changes, there were no additional significant accounting principles or reporting changes implemented in the fiscal year ending January 31, 2007.

Other accounting and reporting changes that occurred during the prior reporting year continued into the fiscal year ending January 31, 2007.

These accounting changes and the effects on the financial statements are described in greater detail in the MD&A and in the notes to the audited financial statements included in APPENDIX B.

PENSION, EMPLOYEE, AND OTHER POST-EMPLOYMENT BENEFITS

CPS provides Pension and Other Post-Employment Benefits ("OPEBs") for its employees. The CPS plans consist of four plans: the Pension Plan, the Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan. All plans are reported on a calendar year basis. See "Notes to Basic Financial Statements – Note 8 – Employee Pension Plan and Note 9 – Employee and Other Post-Employment Benefits" in Appendix B ("Notes 8 & 9").

Pension Plan

The Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan and provides retirement and ancillary benefits for all CPS employees who complete a minimum period of service and/or otherwise become eligible. The benefits provided by the Pension Plan are paid from a Pension Trust Fund established by CPS that is kept separate from and in addition to the benefits employees are entitled to receive under any other CPS program and under the federal Social Security Act. This Pension Plan and the Pension Trust Fund were established by the Board in accordance with applicable law and are maintained for the exclusive benefit of the eligible employees and their beneficiaries.

Employee Benefit Plans

The Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan ("Employee Benefit Plans") are reported as a component unit on CPS' Balance Sheets. See "Appendix B – City Public Service – Audited Financial Statements for the Fiscal Years Ended January 31, 2007 and 2006" herein and the related footnote disclosures. These Employee Benefit Plans are funded by employee contributions and annual contributions from CPS as determined by the Board in accordance with applicable law. The assets of the Employee Benefit Plans are stated at fair market value. Consistent with the requirements of GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" (Issued November 2004), the Pension Plan is not shown as a component unit on CPS' Balance Sheets.

The Group Health Plan and the Group Life Insurance Plan provide benefits for employees, their spouses, and covered dependents. Additionally, most CPS employees are also eligible for these benefits upon retirement. CPS established each plan as a "risk pool" as that term is defined in the Texas Political Subdivision Employees Uniform Group Benefits Act ("Act"), Chapter 172 Texas Local Government Code. These plans are each operated at all times and in all respects as a risk pool under the Act. CPS' Disability Income Plan, also established as a risk pool, provides income to eligible employees of CPS who become disabled.

PENSION AND OPEB LIABILITIES

Actuarial Value of Plan Assets

CPS annually retains an actuarial firm to perform actuarial valuations for the Pension Plan and each of the Employee Benefit Plans. Conducted in accordance with generally accepted actuarial principles and practices, the actuarial reports summarize the funding status of each plan for the prior two calendar years ending December 31st. The reports also provide projected funding contribution requirements CPS' next fiscal year. The Actuarial Value of the assets of each of the plans represents an adjusted value determined by the actuary, in accordance with industry standards, and therefore will not equal the amounts shown in the CPS Balance Sheets.

Actuarial Accrued Liability

The Actuarial Accrued Liability ("AAL") is calculated on a present value basis. Significant actuarial assumptions used in the calculations include, but are not limited to, rates of mortality, rates of retirement, the estimated number of participants expected to withdraw from the program(s), expected base salary increases, overtime rates, disability rates, medical cost increases, and investment returns. The AAL includes liabilities for current retirees, active employees that are fully eligible and for active employees that are not fully eligible.

Use of Assumptions and Estimates

As set forth herein and in Notes 8 & 9 of Appendix B, the disclosure relating to the Pension Plan and the Employee Benefit Plans are based upon certain assumptions and estimates that may vary based upon the risk factors disclosed herein and in Notes 8 & 9 of Appendix B and to the extent that these assumptions and estimates do not materialize or are inaccurate, the financial information disclosed herein and in Notes 8 & 9 of Appendix B, including the estimated as compared to the actual values of the assets and liabilities, could change substantially and in a materially adverse manner. The actuarial values determined for benefit plan assets and liabilities include reasonable assumptions which are estimates based on information available at the time the study was conducted. The Group Health Plan AAL, as reported below, excludes any offset in costs resulting from the government subsidizing voluntary prescription drug benefits under a new section "Part D" of the Social Security Act, established as part of the Medicare Prescription Drug Improvement and Modernization Act of 2003. The Part-D subsidy pertains to benefits beginning January 1, 2006. On June 30, 2006, GASB issued a Technical Bulletin regarding the Medicare Part-D subsidy. The Technical Bulletin clarified that the Medicare Part-D subsidy should be excluded when reporting the AAL.

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Pension and Employee Benefit/OPEB Funding

The schedule below outlines CPS' Pension and OPEB funding status based on January 1, 2007, 2006, and 2005 Actuarial Valuations. Although CPS is not contractually required to make contributions to fund the future liabilities of the Employee Benefit Plans, it has been voluntarily doing so since 1992.

PENSION AND EMPLOYEE BENEFIT PLANS

(\$ in millions)

	(A) Actuarial Value of Plan Assets			(B) Actuarial Accrued Liability ("AAL")¹		
	January 1			January 1		
	2007	2006	2005	2007 ³	2006	2005
Pension	\$ 1,012.1	\$ 955.3	\$ 902.1	\$ 1,042.0	\$ 906.4	\$ 837.6
OPEBs:						
Group Health	\$ 150.8	\$ 133.9	\$ 121.7	\$ 220.7	\$ 228.4	\$ 233.3
Group Life	49.1	46.7	44.2	45.5	60.9	58.0
Disability ²	3.9	4.1	4.2	5.2	6.0	3.6
Total OPEBs	\$ 203.8	\$ 184.7	\$ 170.1	\$ 271.4	\$ 295.3	\$ 294.9

	(B) - (A) Unfunded AAL			(A) / (B) Funded Ratio		
	January 1			January 1		
	2007	2006	2005	2007	2006	2005
Pension	\$ 29.9	\$ (48.9)	\$ (64.5)	97.1%	105.4%	107.7%
OPEBs:						
Group Health	\$ 69.9	\$ 94.5	\$ 111.6	68.3%	58.6%	52.2%
Group Life	(3.6)	14.2	13.8	107.9%	76.6%	76.2%
Disability ²	1.3	1.9	(0.6)	75.0%	68.3%	116.7%
Total OPEBs	\$ 67.6	\$ 110.6	\$ 124.8	75.1%	62.5%	57.7%

(1) Includes liabilities for retirees, fully eligible actives, and actives not yet fully eligible. The Group Health Plan does not reflect Medicare Part D Subsidy of approximately \$38.8 million for 2007 and \$36.4 million for 2006.

(2) Disability AAL for January 1, 2005 is not presented in accordance with GASB Statement 43.

(3) The actuarial assumptions related to the Pension have been changed since the prior valuation as a result of an experience study and an actuarial assumption review covering the 2001- 2006 actuarial valuation data. The changes in actuarial assumptions increased the AAL as of January 1, 2007 by \$77.7 million.

CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY

The Electric Utility Industry Generally

The electric utility industry in general has been, and in the future may be, affected by a number of factors which could impact upon the business affairs, financial condition and competitiveness of an electric utility and the level of utilization of generating facilities, such as those of the Systems. One of the most significant of these factors is the effort on national and local levels to restructure the electric utility industry from a heavily regulated monopoly to an industry in which there is open competition for power supply on both the wholesale and retail level. (For a description of the competition in the electric utility industry in Texas and the response of the Systems thereto, see "Electric Utility Restructuring in Texas; Senate Bill 7" herein.)

In addition, such factors include, among others, (i) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (ii) changes resulting from conservation and demand-side management

programs on the timing and use of electric energy, (iii) changes that might result from a national energy policy, (iv) increased competition from independent power producers, (v) "self-generation" by certain industrial and commercial customers, (vi) issues relating to the ability to issue tax-exempt obligations, (vii) severe restrictions on the ability to sell to non-governmental entities electricity from generation projects financed with outstanding tax-exempt obligations, (viii) changes from projected future electricity requirements, (ix) increases in costs, (x) shifts in the availability and relative costs of different fuels and, (xi) effects of the financial difficulties confronting the power marketers. Any of these factors (as well as other factors) could have an effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways. CPS cannot predict what future effects these factors may or will have on its business operations and financial condition, but the effects could be significant. The following is a brief discussion of certain of these factors. However, this discussion does not purport to be comprehensive or definitive and these matters are subject to change subsequent to the date of this Official Statement. Extensive information on the electric utility industry is available from sources in the public domain, and potential purchasers of the Bonds should obtain and review such information.

Federal Energy Legislation

In August 2005, the Energy Policy Act of 2005 ("2005 Energy Act"), passed the House and Senate and was signed by the President. There are provisions in this new law that may affect CPS including the extension of limited Federal Energy Regulatory Commission ("FERC") jurisdiction, known as "FERC-Lite", over public power entities such as CPS that own transmission lines, and which give FERC authority to delegate certain transmission reliability standard-setting responsibilities to an Electric Reliability Organization ("ERO") and, with the ERO, establish mandatory reliability standards for operation of the nation's transmission system, even within ERCOT. CPS has operated its electric system under compatible ERCOT reliability standards for many years, so CPS does not anticipate any problems with FERC's reliability standards; however, CPS will not know the impact of FERC-Lite until such time as FERC issues implementing rules that make clear those requirements. Additional information on FERC's authority over CPS can be found in "FERC Authority" herein.

The 2005 Energy Act has additional provisions that could affect CPS' business, which are currently under evaluation by CPS, including:

- repeal of existing Public Utility Holding Company Act of 1935 requirements;
- provision for state and large non-regulated utility consideration of five new Federal Standards - including time-based metering and communications, net metering, fuel generation source diversification, increased efficiency in fossil-fuel generation, and interconnections of on-site consumer generation facilities with utility distribution systems. [Note: municipal utilities such as CPS are designated as "non-regulated" under the 2005 Energy Act because those utilities are not regulated by state utility commissions.];
- conditional termination of the mandatory federal purchase and sale requirements for cogeneration and small power production;
- expansion of FERC's merger review authority;
- reauthorization of renewable energy production incentives for solar, wind, geothermal, and biomass and authorization of new incentives for landfill gas;
- establishment of a 7.5 percent goal for increased renewable energy use by the federal government by 2013, and of a 20.0 percent required reduction in energy use by federal buildings by 2015; and
- increased funding for low-income weatherization and for state energy efficiency programs.

The 2005 Energy Act also has provisions affecting existing nuclear generating units, including:

- extension of the Price-Anderson Act to 2025 and increases in the retrospective premiums for which licensees are liable for claims resulting from a nuclear incident;
- expansion of the Nuclear Regulatory Commission ("NRC") authority to regulate decommissioning trust funds (primarily affecting funds held by former plant licensees);
- direction of the U.S. Department of Energy ("DOE") to take responsibility for safe disposal of high-level radioactive waste;
- procedural protections for individuals filing claims under federal whistleblower provisions;
- enhanced provisions relating to NRC oversight of the security of licensed facilities; and
- various decommissioning tax-related adjustments beneficial to federal tax-paying licensees.

The 2005 Energy Act will affect CPS indirectly. CPS will be required to hold public hearings on and to consider the five new Federal Standards established under the 2005 Energy Act. The indirect impacts of the 2005 Energy Act on CPS cannot be predicted at this time.

FERC Authority

In 1992, pursuant to the Energy Policy Act of 1992 ("Energy Act"), the FERC required utilities under FERC jurisdiction to provide access to their electric transmission systems for interstate wholesale transactions on terms and at rates comparable to those available to the owning utility for its own use. Municipal Utilities like CPS are subject to FERC orders requiring provision of wholesale transmission service to other utilities, qualifying cogeneration facilities and independent power producers. Under FERC rules promulgated subsequent to the Energy Act, FERC further expanded open access wholesale transmission by requiring public utilities operating in interstate commerce to file open access non-discriminatory transmission tariffs. Because the interconnected ERCOT grid operates outside interstate commerce and because PURA95 and SB 7, Texas State laws discussed below, provide comparable wholesale transmission authority to the PUCT for utilities in ERCOT pursuant to which the PUCT has required open access of transmission facilities in ERCOT, the exercise of FERC authority relating to open access transmission has not been a major factor in the operation of the wholesale market in ERCOT. The 2005 Energy Act authorizes FERC to encourage and approve the voluntary formation of regional transmission organizations in order to promote fair and open access to electric transmission service and facilitate wholesale competition. See "Federal Energy Legislation" herein. The ERCOT open access system is administered by an ISO conducting many of the functions that would be administered by a Regional Transmission Organization. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - Interconnected System" herein.

Electric Utility Restructuring in Texas; Senate Bill 7

During the 1999 legislative session, the Texas Legislature enacted SB 7, providing for retail electric open competition. This began on January 1, 2002. SB 7 continues Texas electric transmission wholesale open access, which came into effect in 1997 and requires all transmission system owners to make their transmission systems available for use by others at prices and on terms comparable to each respective owner's use of its system for its own wholesale transactions. SB 7 also fundamentally redefines and restructures the Texas electric industry. The following discussion of SB 7 applies primarily to ERCOT.

SB 7 includes provisions that apply directly to Municipal Utilities such as CPS, as well as other provisions that govern IOUs and electric co-operatives ("Electric Co-ops"). As of January 1, 2002, SB 7 allows retail customers of IOUs to choose their electric energy suppliers. SB 7 also allows retail customers of those Municipal Utilities and Electric Co-ops that elect, on or after that date, to participate in retail electric competition. Provisions of SB 7 that apply to the CPS electric system, as well as provisions that apply only to IOUs and Electric Co-ops are described below, the latter for the purpose of providing information concerning the overall restructured electric utility market in which CPS and the City could choose to directly participate in the future.

SB 7 required IOUs to separate their retail energy service activities from regulated utility activities by September 1, 2000 and to unbundle their generation, transmission/distribution and retail electric sales functions into separate units by January 1, 2002. An IOU may choose to sell one or more of its lines of business to independent entities, or it may create separate but affiliated companies and possibly operating divisions. If so, these new entities may be owned by a common holding company, but each must operate largely independent of the others. The services offered by such separate entities must be available to other parties on non-discriminatory bases. Municipal Utilities and Electric Co-ops which open their service territories ("opt-in") to retail electric competition are not required to, but may, unbundle their electric system components. See "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Service Area" herein.

Entities that have Opted-in to Competition

The following discussion relates to entities that are currently in electric competition in Texas, and does not apply to CPS, but could apply if CPS and the City opt-in to electric competition. Generation assets of IOUs are owned by "Power Generation Companies", which must register with the PUCT and must comply with certain rules that are intended to protect consumers, but they otherwise are unregulated and may sell electricity at market prices. IOU owners of transmission and/or distribution facilities are "Transmission and Distribution Utilities" and are fully regulated by the PUCT. Retail sales activities are performed by "Retail Electric Providers" ("REPs") which are the only entities authorized to sell electricity to retail customers (other than Municipal Utilities and Electric Co-ops within their service areas, or, if they have adopted retail competition, also outside their service areas). REPs must register with the PUCT, demonstrate financial capabilities and comply with certain consumer protection requirements. REPs buy electricity from Power Generation Companies, power marketers, and/or other parties and may resell that electricity to retail customers at any location in Texas (other than within service areas of Municipal Utilities and Electric Co-ops that have not opened their service areas to retail competition). Transmission and Distribution Utilities and Municipal Utilities and Electric Co-ops

that have chosen to participate in competition are obligated to deliver electricity to retail customers and are all also required to transport electricity to wholesale buyers. The PUCT is required to approve the construction of new Transmission and Distribution Utilities' transmission facilities outside the electric system's service territory and may order the construction of new facilities in Texas in order to relieve transmission congestion. Transmission and Distribution Utilities are required to provide access to both their transmission and distribution systems on a non-discriminatory basis to all eligible customers. Retail rates for the use of distribution systems of Municipal Utilities and Electric Co-ops are exclusively within the jurisdiction of these entities' governing bodies rather than that of the PUCT.

SB 7 also provides a number of consumer protection provisions. Each service area within Texas that participates in retail competition has a designated "Provider of Last Resort"; those Providers of Last Resort serving in former service areas of IOUs are selected and approved by the PUCT. The Provider of Last Resort is an REP that must offer to sell electricity to any retail customer in its designated area at a standard rate approved by the PUCT. The Provider of Last Resort must also serve any customer whose REP has failed to provide service. Each Municipal Utility and Electric Co-op that opts-in to retail competition may designate itself or another qualified entity as the Provider of Last Resort for its service territory. In such cases, the respective Municipal Utility or Electric Co-op, not the PUCT will set the electric rates for such respective Provider of Last Resort.

Beginning September 1, 1999, each IOU was required to freeze its then existing rates (except for a fuel factor pass through) and was required to continue to serve its retail customers at such rates until 2002. Beginning January 1, 2002, the unbundled REP of the IOU that held the certificate to provide retail service to an area ("Affiliated REP") was required to reduce electric rates by 6% below the frozen rates and offer that reduced rate ("price to beat") to all residential and small commercial retail customers in the area formerly served by the IOU. The Affiliated REP was not allowed to sell electricity to residential or small commercial customers at any other rate until the earlier of either 40% of the residential or small commercial customers in the area had chosen to be served by other REPs or until January 1, 2005. SB 7 does allow Affiliated REPs to compete for industrial customers and for certain aggregated commercial loads owned by a common entity. The price to beat provisions of SB 7 currently has no direct impact on CPS.

Under SB 7, IOUs may recover a portion of their "stranded costs" (the net book value of certain "non-economic" assets less market value and certain "above market" purchased-power costs) and "regulatory assets", which is intended to permit recovery of the difference between the amount necessary to pay for the assets required under prior electric regulation and the amount that can be collected through market-based rates in the open competition market. SB 7 establishes the procedure to determine the amount of IOU stranded costs and regulatory assets. The PUCT has determined the stranded costs, which have been and will be collected through a non-bypassable competitive transition charge collected from the end retail electric users within the IOU's service territory as it existed on May 1, 1999. The charge is collected primarily as an additional component to the rate for the use of the retail electric distribution system delivering electricity to such end user.

IOUs may recover a certain portion of their respective stranded costs through the issuance of bonds, with a maturity not to exceed 15 years, whereby the principal, interest and reasonable costs of issuing, servicing and refinancing such bonds is secured by a qualified rate order of the PUCT that creates the "competitive transition charge". Neither the State of Texas nor the PUCT may amend the qualified rate order in any manner that would impair the rights of the "securitized" bondholders.

Additional Impacts of Senate Bill 7

Municipal Utilities and Electric Co-ops are largely exempt from the requirements of SB 7 that apply to IOUs. While IOUs became subject to retail competition beginning on January 1, 2002, the governing bodies of Municipal Utilities and Electric Co-ops have the sole discretion to determine whether and when to opt-in to retail competition. However, if a Municipal Utility or Electric Co-op has not voted to opt-in, it will not be able to compete for retail energy customers at unregulated rates outside its traditional electric service area or territory.

SB 7 preserves the PUCT's regulatory authority over electric transmission facilities and open access to such transmission facilities. SB 7 provides for an independent transmission system operator (an ISO as previously defined) that is governed by a board comprised of market participants and independent members and is responsible for directing and controlling the operation of the transmission network within ERCOT. The PUCT has designated ERCOT as the ISO for the portion of Texas within the ERCOT area. In addition, SB 7 (as amended by the Texas Legislature after 1999) directs the PUCT to determine electric wholesale transmission open access rates on a 100% "postage stamp" pricing methodology.

The greatest potential impact on CPS' electric system from SB 7 could result from a decision by the City Council and the Board to participate in a fully competitive market, particularly in light of the fact that CPS is among the lowest cost

producers of electric energy in Texas. On April 26, 2001, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002. However, CPS currently believes that it is taking all steps necessary to prepare for possible competition in the unregulated energy market, should the City Council and the Board make a decision to opt-in, or future legislation forces Municipal Utilities and Electric Co-ops into retail competition.

Any future decision of the City Council and the Board to participate in full retail competition would permit CPS to offer electric energy service to customers located in areas participating in retail choice that are not presently within the certificated service area of CPS. The City Council and the Board could likewise choose to open the CPS service area to competition from other suppliers while choosing not to have CPS compete for retail customers outside its certified service area.

As discussed above, Municipal Utilities and Electric Co-ops will also determine the rates for use of their distribution systems after they open their territories to retail competition, although the PUCT has established by rule the terms and conditions applicable to have access to those systems. SB 7 also permits Municipal Utilities and Electric Co-ops to recover their stranded costs through collection of a non-bypassable transition charge from their customers if so determined by such entities through procedures that have the effect of procedures available to IOUs under SB 7. Unlike IOUs, the governing body of a Municipal Utility determines the amount of stranded costs to be recovered pursuant to rules and procedures established by such governing body. Municipal Utilities and Electric Co-ops are also permitted to recover their respective stranded costs through the issuance of bonds in a similar fashion to the IOUs. Any decision by CPS as to the magnitude of its stranded costs, if any, would be made in conjunction with the decision as to whether or not to participate in retail competition.

A Municipal Utility that decides to participate in retail competition and to compete for retail customers outside its traditional service area will be subject to a PUCT-approved code of conduct governing affiliate relationships and anti-competitive practices. The PUCT has established by a standard rule the terms and conditions, but has no jurisdiction over the rates, for open access by other suppliers to the distribution facilities of Municipal Utilities electing to compete in the retail market. If a Municipal Utility decides to participate in retail competition, its customers are subject to being charged a PUCT-approved System Benefit Fund fee per megawatt hour beginning six months prior to implementation of customer choice. The fee is a contribution to a statewide fund targeted at property tax replacement, low-income programs and customer education.

Among other provisions, SB 7 provides that nothing in the act or in any rule adopted under it may impair any contracts, covenants, or obligations between municipalities and bondholders of revenue bonds issued by municipalities and that nothing in the act may impair the tax-exempt status of municipalities or compel them to use facilities in a manner that violates any bond covenants or other exemption of interest or tax-exempt status. The bill also improves the competitive position of Municipal Utilities by allowing local governing bodies, whether or not they implement retail choice, to adopt alternative procurement processes under which less restrictive competitive bidding requirements can apply and to implement more liberal policies for the sale and exchange of real estate. Also, matters affecting the competitiveness of Municipal Utilities are made exempt from disclosure under the open meetings and open records acts and the right of municipal utilities to enter into risk management and hedging contracts for fuel and energy is clarified. See "FUEL SUPPLY", "WHOLESALE POWER MARKETING" and "RISK MANAGEMENT" for discussion of CPS' Price Risk Management Program.

During its 79th Legislative Session in 2005, the Texas Legislature reviewed the mission and performance of the PUCT, as required by the Texas Sunset Act. This Act provides that the Sunset Commission, composed of legislators and public members, periodically evaluate a state agency to determine if the agency is still needed, and what improvements are needed to ensure that tax dollars are appropriately utilized. Based on recommendations of the Sunset Commission, the Texas Legislature ultimately decides whether an agency continues to operate into the future.

The 79th Legislature in its review of the PUCT, reauthorized the agency until 2011. Reforms were enacted to increase the accountability of ERCOT, including added regulatory scrutiny and governance changes that add independence while preserving input from industry experts. An "independent market monitor" selected by and reporting to the PUCT, was institutionalized to help guard against manipulation in the Texas wholesale electric market. No significant, direct impact on CPS is anticipated as a result of this legislation.

Post Senate Bill 7 Wholesale Market Design Developments

In the summer of 2003, the PUCT adopted rules requiring that ERCOT transition from a zonal to a nodal wholesale market by October 1, 2006, and requiring that new protocols to accomplish this transition be submitted to the PUCT for review. Implementation of the nodal market will include, among other elements: direct assignment of the costs of local transmission congestion to market participants that cause the congestion; implementation of an integrated, financially binding day-ahead market; and nodal energy prices for resources and zonal energy prices for loads. Consistent with the rule, ERCOT and industry stakeholders have developed and submitted to the PUCT protocols and proposed energy load zones to implement these market design elements, together with an independent cost-benefit analysis. The PUCT in 2005 reaffirmed its intent to implement the nodal market in ERCOT, but modified the implementation date to January 1, 2009. In December 2005, the PUCT conducted a hearing on the nodal protocols submitted by ERCOT, and in April 2006 it issued an order approving the implementation of the nodal market. ERCOT has begun its process of design specification and implementation, which will be followed by design specification and implementation by market participants, including CPS. These activities will continue through early 2008, followed by integration testing and trials leading to the January 1, 2009 implementation date. See "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation" herein.

The 80th Texas Legislative Regular Session adjourned on May 28, 2007. While certain legislation was enacted, CPS believes that this legislation will have no material adverse impact on the Systems, including its financial and other operations.

Environmental Restrictions of Senate Bill 7 and Other Related Regulations

SB 7 contains specified emissions reduction requirements for certain older electric generating units, which would otherwise be exempt from the Texas Commission on Environmental Quality ("TCEQ") permitting program by virtue of "grandfathered" status. Under SB 7, annual emissions of nitrogen oxides ("NO_x") from such units were reduced by 50% from 1997 levels, beginning May 1, 2003. These emissions have been reported on a yearly basis and CPS has met the requirements of its NO_x cap for the applicable units for the past three compliance years. CPS has final Electric Generating Facility ("EGF") State permits from the TCEQ for its four older electric generating plant sites, comprising of 11 gas-fired units. CPS may require future additional expenditures for emission control technology. See "ENVIRONMENTAL MATTERS – Federal Clean Air Act" and "CONSTRUCTION PROGRAM" for a discussion of the cumulative economic effect of these requirements together with requirements under Federal Clean Air Act permits.

Although SB 7 instituted many of the changes to environmental emission controls which affect grandfathered electric generating plants, another TCEQ regulation, Chapter 117, is directed at all units in the state, including CPS' coal plants. These regulations required a 50% reduction in NO_x emissions statewide beginning May 1, 2005 and system-wide on an annual basis. The first reporting period for CPS' power plants subject to the Chapter 117 cap was for the compliance period May 1, 2005 to April 2006. CPS has met the Chapter 117 cap for each compliance period. As a result of the J.K. Spruce Plant Unit 2 ("JKS 2") air permitting process, CPS has committed to tighter NO_x emission limitations than what is required under Chapter 117 at the Calaveras Lake site once the JKS 2 unit comes on line. The final Clean Air Interstate Rule ("CAIR") has imposed even more NO_x restrictions on CPS power plants as described in "ENVIRONMENTAL MATTERS". Changes to environmental emission controls may have the greatest effect on coal plants. For example, mercury emission limits have been finalized by the Environmental Protection Agency ("EPA"), which may require new controls at the coal plants in the near future as is discussed in "ENVIRONMENTAL MATTERS – Federal Clean Air Act" herein. Further statutory changes and additional regulations may change existing cost assumptions for electric utilities. While it is too early to determine the extent of any such changes, such changes could have a material impact on the cost of power generated at affected electric generating units.

RESPONSE TO COMPETITION

In order to prepare to operate successfully in the new competitive environment created by the enactment of SB 7, CPS has developed a marketing plan that focuses on retaining the retail customers in its historic service areas and active participation in wholesale markets. Programs concentrate on not only meeting all customers' traditional needs, but also on providing products and services that provide comfort and convenience for residential customers and improve productivity and reduce costs for commercial and industrial customers. In addition, CPS is improving internal and external communications, promoting participation in a wide variety of community initiatives, staying actively involved with regulatory issues, and focusing on the strategies and objectives at the corporate and business unit levels which have been identified as critical to success.

Looking to the future, CPS plans to continue providing low cost generation and high levels of reliability to the communities it serves, while working on customer retention by improving and developing strong customer loyalty. As a step in diversifying its energy resource plan, CPS is aggressively pursuing renewable energy supplies. CPS is currently receiving renewable energy under long term, 20-year contracts for 160 megawatts ("MW") of wind-generated electricity from the Desert Sky Wind Project, in Pecos County and for 100 MW from the Cottonwood Creek Wind Farm located south of Sweetwater, Texas. CPS has also signed 20-year contracts for an additional 240 MW from an expansion to the Cottonwood Creek Wind Farm. This expansion is expected to be operational by December 2007. CPS also has a landfill gas-generated energy project totaling 9.6 MW which came on-line in December 2005. This capacity totals more than 510 MW in service or under contract. CPS has one of the most aggressive renewable energy programs in Texas with a renewable capacity equivalent to nearly 11.6% of its historic peak power requirement.

With respect to state and national legislative action regarding competition, CPS continues to participate actively in the legislative process to voice the interests of Municipal Utilities and play an integral part in shaping the new environment in which it will operate. CPS continues to evaluate the price components of the energy services it provides, recognizing that the price for electricity will be a paramount factor for succeeding in a deregulated environment. Cost containment initiatives coupled with additional phases of debt management strategies will continue in the years ahead.

In conjunction with the onset of deregulation and retail competition, overall merchant plant activity in ERCOT increased significantly in recent years, with more than 30,485 MW of new generation completed since wholesale competition was introduced in September 1995. The result of these capacity additions has been a strong downward pressure on wholesale power prices that, in turn, has led several companies to decommission or "mothball" less efficient power plants. According to information posted at the PUCT website, as of March 6, 2007, 15 facilities (6,261 MW) were mothballed since September 1995 and 27 facilities have been retired (3,625 MW) since 2002. Wholesale prices recovered during the summer of 2005 due to strong demand and higher temperatures. CPS was a net seller of power when excess capacity was available. The market is constantly monitored, and CPS continues to purchase or sell on a daily basis to optimize use of its generation portfolio.

Strategic Planning Initiatives

CPS has a comprehensive corporate strategic plan that is designed to make CPS more efficient and competitive, while delivering value to its various customer groups and the City. On August 22, 2005 the Board approved a new strategic plan, developed by a cross-functional team. The plan built on the CPS mission, vision, and core values as well as long-term goals adopted in 2004 as part of the Vision 2020 process. The strategic plan has evolved to formulate plans for its wholesale, retail, transmission and distribution, gas, and shared services business units. Each plan will be the responsibility of the business unit and will focus on market tactics, organizational development, business information, process improvement, legal/regulatory issues and financial accomplishment. The senior executive for each business unit has accountability for development and delivery of the plan.

Major initiatives and key action plans necessary to accomplish the objectives and meet or exceed the targets are also included in each plan. Status reports are provided to the Board and senior management on a regular basis. An oversight team, appointed by senior management, ensures consistency with Vision 2020 and directs the resolution of cross-business unit issues.

Debt and Asset Management Program

CPS has developed a debt and asset management program ("Debt Management Program") for the purposes of lowering the debt component of energy costs, maximizing the effective use of cash and cash equivalent assets and enhancing financial flexibility. An important part of the Debt Management Program is debt restructuring through the prudent employment of variable rate debt and possible interest rate swap contracts. It is anticipated, however, that the variable rate exposure of CPS will not exceed 25% of total outstanding debt. The program also focuses on the use of unencumbered cash and available cash flow to redeem debt ahead of scheduled maturities as a means of reducing outstanding debt. The Debt Management Program is designed to lower interest costs, fund strategic initiatives and increase net cash flow.

Current Economic Developments

CPS works independently as well as with the San Antonio Economic Development Foundation and other local economic development agencies to recruit targeted businesses into the CPS service territory. The 2006 CPS corporate strategic planning initiative included an exercise to revise the list of business targets to pro-actively recruit into the service area. This analysis concluded that recruitment, retention and expansion of the following industries have the most potential advantage to CPS: advanced manufacturing (including aviation, aerospace, automotive), life sciences/bio-medical, homeland security, information technology (including data centers, financial service centers, insurance and back office operations) and large-scale retail developments.

During 2006, CPS' economic development recruitment efforts have resulted in a total of 23 corporate locations with the potential to create over 4,000 new jobs. The largest of these company announcements include Sino-Swearingen (a business jet manufacturer), Lowes Companies (data center), Cadillac Automotive Products (automotive component parts manufacturer), American Funds (financial services), Accenture (customer care center) and Afni (call center).

Work continues on the Texas Cryptologic Center in San Antonio. The Texas Cryptologic Center has committed to establish a regional cryptology center to support its communications intelligence – retaining and creating almost 2,000 jobs over the next few years. At full build-out, this center could result in an additional load of over 40MW onto the CPS system.

Production began in late 2006, at the Toyota Motor Manufacturing Texas (“TMMTX”) facility in San Antonio. The first of the “Texas Tundra” trucks are now in dealer showrooms across the country. The facility is ramping up production to 150,000 trucks per year. TMMTX has hired over 1,800 individuals to date and is on its way to a projected total employment of 2,000. Additionally, full production is underway at the on-site vendor park for the 21 Tier One suppliers who are employing over 2,100 persons. The combined investment of the TMMTX facility and their on-site suppliers equals \$1.1 billion. CPS will initially supply an estimated 32 MW electric load and gas transport for the delivery of 770,000 MMBtu/year for the project. TMMTX and CPS have an agreement in place that calls for TMMTX to obtain electricity and transport natural gas services exclusively from CPS for 15 years from the start of production.

The first quarter of 2007, has seen continued new economic developments for the CPS service territory. Microsoft Corporation announced in January that a new \$550 million data center will be built in the western portion of the service territory. CPS staff worked with Microsoft for over one year to recruit this data center and its potential 40 MW load. Plans are for the center to be operational in June 2008. As a result of Microsoft and Lowes, CPS has received inquiries from and is actively pursuing several additional data center projects. One of the principal reasons these centers are considering San Antonio is the presence of CPS – a municipally-owned utility providing reliable, competitive electric service to companies that demand high quality and reliable electric service.

While attracting new companies is important, CPS economic development efforts also focus on the retention and expansion of existing companies. During the 1st quarter of 2007, efforts to retain existing companies resulted in keeping one major company from looking elsewhere. Maxim Integrated Products has made the decision to expand in San Antonio by refurbishing and occupying an existing building next to their present site as opposed to expanding their operations at competing plant locations in Japan and California. The Maxim expansion will result in CPS keeping a 6 MW load customer and increasing their electric usage by an estimated 20%.

CONSTRUCTION PROGRAM

Comprehensive programs for planning and construction to meet current and future electric and gas systems needs are continually being reviewed and updated. CPS utilizes computer-based mathematical models for its forecasting processes. CPS bases its near-term construction and operating needs on a five-year forecast. This short-term annual forecast is supported by a 35-year electric resource plan and a 25-year electric transmission facilities plan. These assumptions are subject to substantial change and will be revised as necessary to maintain CPS' competitive position.

In addition, CPS expects to see continued growth in its customer base for the electric and gas systems due to projected population growth in the San Antonio area. The energy sales forecast predicts annual increases of 3.54% and 0.23% in electric and gas sales, respectively, over the next 25 years. The summer 2006 forecast projects a peak demand growth rate averaging 3.16% per year for the next 25 years. CPS has continued to expand its electric customer extensions, with ongoing construction growth in this area. The capital projects in fiscal year 2007-08 are planned to be funded with transfers from the Repair and Replacement Account, debt proceeds, and other sources.

A capital improvement plan is made for planning purposes and may identify projects that will be deferred or omitted entirely in future years, and in addition, the proposed funding sources for the plan may be modified to meet changing conditions. Likewise, as conditions change, new projects may be added that are not currently identified. CPS' current \$4.294 billion, five-year capital improvement plan is forecasted from February 1, 2007 to January 31, 2012. Construction projects include electric transmission, electric generation, electric distribution, general properties, and gas facilities.

Over the five-year period covered by the current capital plan, construction funding from debt proceeds averages approximately \$550.0 million per year, with other major sources of funding for the plan consisting of internally generated funds.

The Community Infrastructure and Economic Development Fund ("CIED") was established by Board policy on January 19, 2005, as a successor to the Overhead Conversion Fund ("OCF"). The OCF was originally instituted in 1993, by the Board in response to interest by the citizens and governing bodies of the City and the suburban cities within the CPS service area to enhance the aesthetic appeal of the public areas by minimizing the visual impact of overhead electric facilities. The OCF amount, set annually, equaled one percent (1%) of the base electric revenue (less uncollectibles) of the CPS electric system billed during the previous fiscal year to retail electric customers of CPS residing within the City and each of the suburban cities. For several reasons, including the high cost of converting overhead facilities to underground, the City and the suburban cities had difficulty spending the OCF monies on an annual basis. In late 2004, CPS was asked to consider expanding the potential uses of the fund. CPS will continue to make all or any part of the monies available for "traditional" OCF projects (re-routing or undergrounding), but will also make the funds available for certain eligible economic development and environmental stewardship/energy efficiency projects. Such projects are evaluated for their ability to improve the environment, create new jobs, and generate new electric and gas revenues. Both of these new allowable uses (economic development and environmental stewardship) require a positive cost-benefit finding, meaning that CPS is likely to receive greater economic return as a result of the project being eligible to receive CIED Fund monies and other investments applied toward the project. Additionally, economic development and environmental stewardship allocations from the CIED Fund can only be applied towards capital projects owned by a public purpose entity. The CIED Fund allocable to all the beneficiary entities as of January 31, 2007 totaled \$66.2 million.

By further policy change effective January 2006 and by City ordinance passed in February 2006, CPS agreed to transfer monies allocable to the City under the CIED Fund Policy. The transfer is subject to the limitations that the: (1) total annual City transfer from the gross revenue of the Systems, inclusive of the CIED fund transfers, does not exceed 14% of CPS' total gross revenues (in compliance with the Bond Ordinances) and (2) the CIED fund transfer does not exceed 1% of electric base rates paid by residents of the City.

DESCRIPTION OF PHYSICAL PROPERTY

ELECTRIC SYSTEM

Generating Plants

CPS operates 19 electric generating units, three of which are coal-fired and 16 of which are gas-fired. Some of the gas-fired generating units may also burn fuel oil, which provides greater fuel flexibility and reliability. With the acquisition of an additional 300 MW purchased from AEP Texas Central Company ("AEP TCC"), as of May 19, 2005, CPS has a 40.0% interest in STP's two nuclear generating units. The nuclear units supplied 38% of the electric system load during fiscal year 2006 - 07. See "South Texas Project" herein.

The J.T. Deely, J.K. Spruce, and O.W. Sommers Plants are located at Calaveras Lake southeast of the City and share the lake's cooling capacity. The J.T. Deely Plant consists of two units that are equipped to burn coal. Like the Deely Plant units, the J.K. Spruce Plant burns low sulfur western coal from the Powder River Basin area of Wyoming. Additional agreements with other suppliers are initiated as needed for additional purchases of coal. These three coal units provided 43.6% of the electric system load for fiscal year 2006-07. The O.W. Sommers Plant comprises two units, which are capable of operating on either natural gas or fuel oil.

CPS entered into a financial lease/leaseback transaction with an affiliate of Unicom Corporation involving CPS' J.K. Spruce Unit 1 in June 2000. Unicom Corporation has subsequently merged into Exelon Corporation. The Balance Sheets and related notes in APPENDIX B include items related to this transaction. See discussion under "POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS" herein.

The V.H. Braunig Plant is located on Braunig Lake, also southeast of the City. It has three units that can operate on either natural gas or fuel oil.

The Arthur von Rosenberg Plant, located adjacent to the V.H. Braunig Plant, uses a combined cycle operation to generate 15.0% more electric power from natural gas than other gas generation methodologies. The plant also utilizes an environmental control system producing NO_x emissions below other existing CPS plants and 95.0% lower than the national average for fossil fuel-fired plants.

While STP and the plants at Calaveras and Braunig lakes now provide most of CPS' generation, two older plants are also available to provide generation during peak load periods. They are the W.B. Tuttle Plant and the Leon Creek Plant. These plants burn only natural gas and are cooled by ground water re-circulated through cooling towers. In June 2004, four new natural gas combustion turbine peaking units were added to the Leon Creek Plant site. The W.B. Tuttle Unit 2 and the Leon Creek Unit 4 have been mothballed. Leon Creek Unit 4 is planned to return to service in the summer of 2007. The W.B. Tuttle Unit 2 will be retired. The W.B. Tuttle Unit 1 and Leon Creek Unit 3 have been de-rated, reducing their generating capability. The reduction in generating capability is negligible since it is less than one percent of CPS' total generating capacity.

The peak load for fiscal year 2006-07, was 4,407 MW. On August 17, 2006 a new peak was reached at 4,407 MW, which broke the record peak of 4,374 set the previous day. With a generating capacity of 5,216 MW at the time of the new peak, the reserve margin was 15.5%. See "Generating Capability" herein.

Authorization to proceed with the permit application on a new coal-fired unit was received from the Board in late June 2003. In November 2003, CPS filed with TCEQ an application for permits associated with construction and operation of a new 750 MW coal-fired generating station to be co-located with the J.K. Spruce Plant Unit 1 coal-fired generating station. The TCEQ approved the permit in December 2005. The ground breaking for the new coal-fired unit took place on March 21, 2006, and in-service date is planned for summer 2010. Construction is being performed under a fixed-price contract by the Calaveras Power Partners, a partnership of Black & Veatch, Zachry Construction and The Industrial Company. See "ENVIRONMENTAL MATTERS – Other Environmental Issues" for further discussion.

CPS is planning to add approximately 200 MW of combustion turbine peaking units to the V.H. Braunig Plant site. The number of units and capacity of each unit will be determined later in 2007 as engineering work progresses. The new units are scheduled to be operational by the summer of 2009.

Braunig Lake has additional cooling capability for future generating units. This man-made lake covers approximately 1,350 surface acres and utilizes treated sewage effluent and runoff waters. CPS was a pioneer in the use of non-potable, recycled water for cooling purposes, thereby saving higher, potable quality underground water for other uses.

San Antonio Water System ("SAWS") is obligated to provide 40,000 acre-feet of treated wastewater per year to CPS. CPS may increase this amount by two contingent 5,000 acre-feet options that are dependent on the availability of the sewage effluent, at prices escalated to the date of exercise. Current water needs are being met with the original SAWS 40,000 acre-feet obligation. Due to system growth and construction of new generating units and to assure adequate water supplies in the future, CPS has asked to exercise its first option that expires in June 2007. The second option expires in 2011. CPS projects that these contract volumes, along with water available under existing permits, will provide sufficient cooling capacity for any planned generation units at these lakes.

CPS owns 1,274 aluminum railroad cars which are used in unit trains to haul coal from mines in Wyoming and other locations to the J.T. Deely Plant and the J.K. Spruce Plant. CPS performs its own railroad car maintenance and servicing at its railroad car maintenance facility located at Calaveras Lake.

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Generating Capability

Plant ¹		Fuel	Year Installed	Net Capability MW ²	Total Capability MW ²
STP (40.0% interest) ³	Unit 2	Nuclear	1989	540	
	Unit 1	Nuclear	1988	540	1,080 Nuclear
J.K. Spruce Plant	Unit 1	Coal	1992	595	
J.T. Deely Plant	Unit 2	Coal	1978	415	
	Unit 1	Coal	1977	415	1,425 Coal
A. von Rosenberg Plant ⁴	Unit 1	Gas	2000	481	
O.W. Sommers Plant	Unit 2	Gas/Oil	1974	435	
	Unit 1	Gas/Oil	1972	445	
V.H. Braunig Plant	Unit 3	Gas/Oil	1970	420	
	Unit 2	Gas/Oil	1968	240	
	Unit 1	Gas/Oil	1966	225	
W.B. Tuttle Plant	Unit 3	Gas	1961	100	
	Unit 2 ⁵	Gas	1956	0	
	Unit 4 ⁶	Gas	1963	160	
	Unit 1 ⁶	Gas	1954	50	
Leon Creek Plant	Unit 4 ⁵	Gas	1959	0	
	Unit 3 ⁶	Gas	1953	60	
	CT 4 ⁷	Gas	2004	47.5	
	CT 3 ⁷	Gas	2004	47.5	
	CT 2 ⁷	Gas	2004	47.5	
	CT 1 ⁷	Gas	2004	47.5	2,806 Gas/Oil
Total Capability owned by CPS				<u>5,311</u>	<u>5,311</u>
Purchased Power:					
Desert Sky Wind Farm		Wind	2002	160	
Cottonwood Creek Wind Farm		Wind	2005	100	260 Wind
Covel Gardens		Landfill Gas	2005	9.6	9.6 Landfill Gas
Total Purchased Power				<u>269.6</u>	<u>269.6</u>
Total Capability including Wind and Landfill Gas				<u>5,580.6</u>	<u>5,580.6</u>

(1) At January 31, 2007.

(2) For gas/oil fueled units, the capabilities shown are the gas ratings.

(3) STP Units 1 and 2 are performing at increased capabilities due to upgrades. See "South Texas Project" below.

(4) Net capability reflects summer rating.

(5) W.B. Tuttle Unit 2 and Leon Creek Unit 4 have been mothballed. W.B. Tuttle Unit 2 will be retired and Leon Creek Unit 4 is planned to returned to service in summer of 2007.

(6) W.B. Tuttle Unit 1 (from 65 MW to 50 MW), and Leon Creek Unit 3 (from 65 MW to 60 MW) were de-rated.

(7) Combustion Turbine.

South Texas Project

STP is a two-unit nuclear power plant; Unit 1 and Unit 2 have a nominal output of approximately 1,350 MW each. STP is located on a 12,220 acre site in Matagorda County, Texas, near the Texas Gulf Coast, approximately 200 miles from San Antonio. CPS currently owns 40.0% of STP. On February 2, 2006, NRG Energy ("NRG Energy"), headquartered in Princeton, New Jersey, acquired all the outstanding equity of Texas Genco LLC, the parent of Texas Genco LP, including its interest in STP.

STP Participant Ownership ("Participants") in the STP and their shares therein are as follows:

Participants	Ownership Effective February 2, 2006	
	%	MW (approximate)
NRG Energy	44.0	1,188
CPS	40.0	1,080
City of Austin-Austin Energy	16.0	432
	<u>100.0</u>	<u>2,700</u>

STP is maintained and operated by a non-profit Texas corporation ("STP Nuclear Operating Company") financed and controlled by the owners pursuant to an operating agreement among the owners and STP Nuclear Operating Company. Currently, a four-member board of directors governs the STP Nuclear Operating Company, with each owner appointing one member to serve with the STP Nuclear Operating Company's chief executive officer. All costs and output continue to be shared in proportion to ownership interests.

STP Units 1 and 2 each have a 40-year NRC license that expires in 2027 and 2028, respectively. No firm decision has been made with respect to license extension; however, under NRC regulations, the STP owners may not make a license extension request until the plant licenses are within 20 years of the license expiration date.

During the twelve-months ended January 31, 2007, the STP Units 1 and 2 operated at approximately 93.1% and 102.5% of net capacities, respectively. Unit 1 completed a normal refueling outage in the fall of 2006 which included replacement of all three low pressure turbines. Unit 2 completed a normal refueling outage in the spring of 2007 in which all three of its low pressure turbines were replaced. The replacement of low pressure turbines and other plant upgrades during these outages improved plant efficiency and yielded an average increase in electrical output of approximately 68 MW in each unit.

Five-Year South Texas Project Capacity Factor

	Calendar Years Ended December 31,					2007 ²
	2002	2003 ¹	2004	2005	2006	
Unit 1	99.2%	62.6%	100.8%	90.0%	92.6%	93.1%
Unit 2	<u>75.0</u>	<u>81.4</u>	<u>93.7</u>	<u>90.6</u>	<u>102.5</u>	<u>102.5</u> ³
Total	87.1%	72.0%	97.2%	90.3%	97.6%	97.8%

(1) Unit capacities in 2003 were lower than typical capacity values because of the unplanned outages in both units.

(2) Twelve months ended January 31, 2007.

(3) Capacity Factor based on nameplate rating of 1250.6 MW per unit.

Recent operational highlights for STP include the following: In 2006, for the third year in a row, STP led the nation in generation from a two-unit site. In total generation, Unit 2 ranked #1 in the U.S. and #3 in the world. Despite the planned outage, Unit 1 ranked #6 in the U.S. and #17 in the world.

The NRC evaluates plant performance by analyzing two distinct inputs: inspection findings from the NRC's inspection program and performance indicators that are reported by the licensee. Inspection findings and performance indicators are given a color designation based on their safety significance. The current plant assessment for STP can be found at a summary level at http://www.nrc.gov/NRR/OVERSIGHT/ASSESS/pim_summary.html, or by writing to U.S. Nuclear Regulatory Commission, Public Document Room, O-1F-13, Washington, D.C. 20555.

The NRC rules require that each holder of a nuclear plant operating license submit to the NRC a decommissioning plan which contains, among other things, a cost estimate for decommissioning such plant and either a funding plan or a guaranty method for covering decommissioning costs for such plant. Participants in STP have filed a decommissioning plan for the STP in compliance with these rules, which includes representations by each STP Participant that it has established a trust into which it annually pays, throughout the life of the STP, amounts which, when accumulated with investment income, will provide the funds required by the rules to pay its respective portion of such costs.

CPS maintains decommissioning funds for its 28.0% interest in STP separate from decommissioning funds associated with its recently acquired 12.0% STP interest ("former AEP TCC interest") to meet its decommissioning obligations for its entire 40.0% interest in STP. See Note 11 to CPS' audited financial statements in APPENDIX B. As of December 31, 2006, the CPS balance in the City Public Service Restated Decommissioning Master Trust for the South Texas Project Decommissioning Trust ("STP Decommissioning Trust") to decommission CPS' 28.0% interest in STP was \$254.9 million and exceeded NRC requirements by \$167.6 million. With respect to decommissioning funds for the former AEP TCC interest, the acquisition by CPS and Texas Genco of AEP TCC's interest in STP includes, proportionately, the responsibility for decontamination and decommissioning, but also resulted in the transfer of decommissioning funds held in trust by AEP TCC. Under PUCT Substantive Rule 25.303, AEP TCC will continue to collect decommissioning fees from its historical retail customers, which are paid into new trust accounts applicable to the new shares of STP acquired by CPS and Texas Genco. These fees are subject to review and adjustment by the PUCT at its initiative or at the request of an interested person including CPS or Texas Genco. As of December 31, 2006, the CPS balance in the Decommissioning Master Trust Related to the South Texas Project Interest Acquired from AEP Texas Central Company, "Master Trust (TCC

Funded)” was \$82.2 million. As of December 31, 2006, the balance in the Master Trust to decommission CPS’ 12.0% interest in STP exceeded NRC requirements by \$44.8 million. See “INVESTMENTS – STP Decommissioning Funds” and “Master Trust (TCC Funded)” for information concerning the value of investments in the decommissioning trusts. Actual decommissioning costs could vary substantially from the estimate of such costs depending on future regulatory requirements, the method used for decommissioning, and other factors, and the amounts in the decommissioning trusts may or may not be adequate to pay these costs.

On June 21, 2006, NRG Energy announced its intention to build several different power plants to add to its existing generation portfolio. As part of this announcement, NRG Energy stated that it had filed a letter of intent with the NRC to build two additional nuclear units at the STP site. While consent from at least one of the other existing STP owners is required for construction of additional units at STP, NRG Energy has started the NRC licensing process for those units on its own. CPS has not made any decision whether it will participate in the development of new nuclear units at STP. Similar to other opportunities to build or purchase existing power plants, CPS has formed a team that has been evaluating the merits of NRG Energy’s proposal.

Qualified Scheduling Entity

CPS operates as an ERCOT Level 4 Qualified Scheduling Entity (“QSE”) representing all of CPS’ assets and load. The communication with ERCOT and the CPS power plants is monitored and dispatched 24 hours per day/365 days a year. Functions are provided from the Energy Market Center housed within the main office. Backup facilities have also been created. QSE functions include load forecasting, day ahead and real time scheduling of load, generation and bilateral transactions, generator unit commitment and dispatch, communications, invoicing and settlement.

Transmission System

CPS maintains a transmission network for the movement of large amounts of electric power from generating stations to various parts of the service area and to or from neighboring utilities and for wholesale energy transactions as required. This network is composed of 138 and 345 kilovolt (“kV”) lines with autotransformers to provide the necessary flexibility in the movement of bulk power.

Interconnected System

The electric system is integrated with more than 100 other utilities, municipalities, independent power producers, power marketers, and co-operatives in Texas to form ERCOT which covers a large portion of Texas. The ERCOT system is operated entirely within the State and is connected to other reliability councils and Mexico through three direct-current lines, providing only limited import/export capability. CPS and the nine utilities below are the major transmission entities in ERCOT:

American Electric Power Service Corporation
Brazos Electric Power Co-op
City of Brownsville Public Utilities Board
South Texas Electric Co-op/Medina Electric Co-op
TXU Electric Delivery, subsidiary of TXU Corp.

Austin Energy
CenterPoint Energy
Lower Colorado River Authority
Texas Municipal Power Agency

The transmission facilities of the nine above entities, along with CPS, have been integrated into a single control area, which is operated by ERCOT acting as the ISO. ERCOT operates the transmission grid through each of the transmission-owning entities that maintain direct control and maintenance of their respective portions of the transmission infrastructure.

Pursuant to the PUCT’s open access transmission rule, discussed under “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation”, ERCOT members and other wholesale market participants jointly established, by a filing with the PUCT in 1996, the ERCOT organization as an ISO and an integrated electronic transmission information network. ERCOT’s responsibilities, which were augmented in 1999 under SB 7 for the pending retail competitive market, include daily administration of the ERCOT transmission tariffs, including alternate dispute resolution procedures, coordination of the scheduling of ERCOT generation and transmission, directing the redispatch of ERCOT generation and transmission transactions for economic purposes, preserving system reliability, and administering the electronic transmission information network. ERCOT also manages commercial operations of the wholesale power market as well as acts as a single clearinghouse for retail customer switches and metering information. ERCOT does not

purchase or sell bulk electricity, nor does it dispatch generation facilities. Beginning July 31, 2001, ERCOT began operating the interconnected system as a single control area, in contrast to the multiple control areas historically in place, as part of the transition to the retail competitive market, which was fully implemented on January 1, 2002. As a participant as a generation entity, load serving entity, and transmission owner in the ERCOT wholesale market, CPS is obligated to comply with all rules established by ERCOT as reflected in its protocols and operating guides, which are subject to change from time to time and subject to oversight and review by the PUCT. ERCOT's costs of converting to a single control area and of administering system operations for the competitive retail market are recovered through an administrative fee assessed to system participants, including CPS, allocated on a load-ratio share basis. CPS recovers the fee through the billing adjustment discussed above under "CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments".

Distribution System

The distribution system is supplied by 72 substations strategically located on the high voltage 138 kV transmission system. The central business district of the City is served by nine underground networks, each consisting of four primary feeders operated at 13.8 kV, transformers equipped with network protectors, and both a 4-wire 120/208 volt secondary grid system and a 4-wire 277/480 volt secondary spot system. This system is well designed for both service and reliability.

Approximately 7,580 circuit miles (three-phase equivalent) of overhead distribution lines are included in the distribution system. These overhead lines also carry secondary circuits and street lighting circuits. The underground distribution system consists of 321 miles of three-phase equivalent distribution lines, 83 miles of three-phase Downtown Network distribution lines, and 3,738 miles of single-phase underground residential distribution lines. Many of the residential subdivisions added in recent years are served by underground residential distribution systems. At January 31, 2007, the number of street lights in service was 70,845. The vast majority of the lights are high-pressure, sodium vapor units.

GAS DISTRIBUTION SYSTEM

Supply Pressure System

The supply pressure system consists of a network of approximately 200 miles of steel mains that range in size from 4 to 30 inches. The entire system is coated and cathodically protected to mitigate corrosion. The supply pressure system operates at pressures between 50 psig and 274 psig, and supplies gas to 266 pressure regulating stations throughout the gas distribution system which reduce the pressure to between 9 psig and 59 psig for the distribution system. A Supervisory Control and Data Acquisition ("SCADA") computer system monitors the gas pressure and flow rates at many strategic locations within the supply pressure system, and most of the critical pressure regulating stations and isolation valves are remotely controlled by SCADA.

Distribution System

The gas distribution system consists of approximately 4,740 miles of 2 to 16-inch steel mains and 1-1/4 to 6-inch high-density polyethylene (plastic) mains. The distribution system operates at pressures between 9 psig and 59 psig. All steel mains are coated and cathodically protected to mitigate corrosion. The vast majority of the gas services are connected to the distribution system, and the gas normally undergoes a final pressure reduction at the gas meter to achieve the required customer service pressure. Critical areas of the distribution system are remotely monitored by SCADA.

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OTHER ELECTRIC AND GAS SYSTEMS STATISTICS¹

	Electric System			Gas System
	Transmission System	Overhead Distribution System	Underground Distr. System & Network	Distribution System ²
Substations	16 ³	72		
Miles of Lines	1,417	7,580	4,701 ⁴ 83 ⁵	
Kilovolts	138/345	13.2/34.5	13.2/34.5	
Miles of Main (Generation: South Gate Pipe Line and Other)			69	4,740
Main Sizes (inches)			24 - 30	1 1/4 - 30
Main Pressures (psig)			275 - 1,118	33 - 274 ⁶
Miles of Main (North Gate Pipeline)				17
Main Sizes (inches)				24
Main Pressures (psig)				931 - 1,118 ⁶

(1) As of January 31, 2007.

(2) Supply Pressure System and Distribution System.

(3) Includes switchyards.

(4) Underground single phase, includes 321 miles three-phase commercial, industrial lines.

(5) Downtown Network three-phase.

(6) Maximum allowable operating pressure.

GENERAL PROPERTIES

Operation Control System

A new primary operations and control center, the Energy Management Center ("EMC"), constructed on the east side of San Antonio was brought on line in October 2004. From this location, system operators use SCADA systems to monitor and control the CPS electric transmission and distribution systems, and the CPS gas supply pressure and distribution systems. All substations, power plants and major gas regulating points are continually monitored and displayed on one-line diagrams on video screens. Abnormalities register an alarm and the system operator can reset certain circuit breakers and valves as required, maintaining delivery of gas or electric service. In addition to the control capability, the system gathers data that is recorded on a computer for various reporting needs. The operation and control function located at the Jones Avenue facility, upgraded and expanded in 1999, serves as the secondary/back-up control center to ensure continued reliability of utility service to CPS' customers in the event of the loss of the EMC.

Support Facilities

The operating systems are supported by modern shops for the maintenance of such items as meters, transformers, communication equipment, vehicles, railroad cars and heavy construction equipment. These shops, together with warehouses, supervisory offices, service centers and vehicle storage, are strategically located throughout the service area to minimize driving time to work locations.

General Offices and Customer Service Centers

The Main Office Complex makes up CPS' General Offices and is located at the intersection of Navarro and Villita Streets in downtown San Antonio. Executive, administrative, financial, information technology and engineering functions are located at this location. The Main Office Building is comprised of 11 floors of office space (with adjacent parking). The Navarro Office Building/garage facility provides three floors for office space and is connected to the Main Office Complex by an enclosed elevated walkway.

CPS' customer service center staff provides information concerning customer accounts and processes customer payments. Customer Service Centers and authorized pay agents are geographically located on the north, east, and west sectors of the service area. These centers are convenient to the customers' homes and in locations readily accessible to freeways. The Northside Customer Service Center serves as a customer service walk-in center, CPS customer call center, and additional general office space for personnel. The facility is an environmentally friendly facility utilizing various forms of renewable and alternative energy.

Construction Centers and Service Centers

CPS recently added one construction center. The primary function of this center is to pilot the newly redesigned new service delivery process which is limited to new construction. In addition, CPS maintains four construction centers, accommodating electric and gas construction, repair and maintenance services, support personnel for administration, planning, training, and warehousing functions and two service centers. The Salado Street Central Garage Service Center serves as the primary central garage for heavy equipment and vehicle repair and maintenance functions, with a separate building housing a central printing shop and warehousing.

Assembly Building

The Villita Assembly Building is located in downtown San Antonio near the Main Office Complex. The main hall has a capacity to accommodate 2,000 people as an auditorium or 1,200 for a dinner function. The building is used for CPS sponsored meetings and events and leased out to local civic, community, and non-profit organizations for major banquets, meetings and social events.

Vehicles and Work Equipment

CPS operates and maintains a fleet of automobiles, trucks, and heavy construction equipment. The garage facilities, located at CPS' service and construction centers are staffed with trained mechanics that provide a majority of the maintenance performed on the vehicles and equipment. Major maintenance on heavy construction equipment is performed at the Salado Street Central Garage Service Center.

SUMMARY OF INSURANCE PROGRAMS

CPS maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major financial risks. The property insurance program provides \$4.25 billion of replacement value for property and boiler, machinery loss coverage including comprehensive automobile coverage, fire damage coverage for construction equipment, and valuable papers coverage. The deductible for the property insurance policy is \$5.0 million per occurrence with a secondary deductible of \$1.0 million per occurrence applicable to non-power plant and non-substation property locations. The liability insurance program includes (1) general liability coverage, (2) workers compensation coverage, and (3) liability coverage and employment practice liability coverage. Other property and liability insurance coverage includes employee travel, event insurance, and commercial crime. CPS also maintains insurance reserves, which totaled \$8.6 million as of January 31, 2007, to cover losses under the self-insurance portion of the insurance program.

CPS and the other participants in STP maintain NRC-required nuclear liability, worker liability, and property insurance, each of which includes provisions for retrospective assessments depending on occurrences at STP and other commercial nuclear plants. CPS is liable for 40.0% of the premiums and any retrospective assessments with respect to STP insurance, and for costs of decontamination, repairs or replacement of damaged property in excess of policy limits; however, under PUCT regulations, AEP TCC's historical customers bear the risk associated with decommissioning that portion of STP previously owned by AEP TCC.

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ENVIRONMENTAL MATTERS

CPS operations have the potential to affect the environment in a variety of ways, including through discharges to the land, air and water. To minimize environmental impact, CPS constructs and operates its facilities according to the standards established for the utility industry by Federal, State, and local laws and regulations. CPS' commitment to the environment is evidenced by its official environmental policy, which places the responsibility for regulatory compliance on all CPS employees, regardless of job function or title. A full-time Environmental Department consisting of educated and trained professionals oversees the enforcement of this policy. Since 1996, over 100 environmental operating procedures ("EOPs") have been and continue to be developed to provide guidance to CPS employees as to how to perform their jobs in a way that protects the environment. Numerous courses are conducted to promote an understanding of how these EOPs apply to job functions.

Federal Clean Air Act

Congress enacted the Clean Air Act Amendments of 1990 ("Clean Air Act Amendments") with the intent of improving ambient air quality throughout the United States. All of CPS' generating units in Bexar County have been issued Federal Operating (Title V) permits and Federal Acid Rain (Title IV) permits under the Clean Air Act by the TCEQ.

Sulfur Dioxide: One objective of the Clean Air Act Amendments is to reduce emissions of sulfur dioxide ("SO₂"), a gaseous pollutant formed during the combustion of coal by coal-burning power plants. The J.K. Spruce Plant Unit 1 and the J.T. Deely Plant Unit 1 and Unit 2 became subject to the Clean Air Act Amendments' SO₂ emission allowance system. An "allowance" is an authorization to emit one ton of SO₂ during or after a specified year. Under the emission allowance system, each affected generating unit is issued annually a number of allowances, based upon a variety of factors. No utility may emit more tons of SO₂ in a year than is authorized by its total allowances. Allowances issued to one generating unit may be used by a utility to offset the emissions of another generating unit. Allowances not needed by the recipient utility for its current emissions may be banked for future use, or they may be sold or otherwise transferred to others. CPS plans to upgrade the scrubber prior to the JKS 2 unit coming on line because of a commitment made in the JKS 2 air permitting process which required JKS 1 to reduce SO₂ emissions by the amount expected to be emitted by JKS 2. A new EPA rule called the Clean Air Interstate Rule ("CAIR"), published in May of 2005, greatly reduces the number of allowances allocated to each utility starting in 2010 with further reductions by 2015. The rule will allow units to use sulfur dioxide allowances they have built up over the years at various ratios, which CPS feels would cover the Deely units' operation until scrubbers are installed there in the 2012 to 2013 time frame.

Nitrogen Oxides: In addition to SB 7 regulations that require NO_x reductions at CPS' formerly grandfathered gas units, TCEQ implemented additional rules called Chapter 117 regulations requiring all coal-fired power plants to achieve a NO_x emission level cap that was based on a NO_x emission rate of 0.165 lb/MMBtu by the year starting mid-2005 and all previously grandfathered gas-fired units to achieve a NO_x emission level cap that was based on a NO_x emissions rate of 0.14 lb/MMBtu. CPS met the limits for the calendar year 2006. The final CAIR reduces the NO_x emission rate to less than 0.15 lb/MMBtu in the first Phase and will be accomplished via statewide allocations that are required to be met in 2009 with further reductions by 2015. The new rule is a cap and trade rule which means that specific units are not required to meet any particular emission limit, only that they have adequate NO_x allowances for what they actually emit. CPS is undergoing careful study of the potential NO_x controls that may be required prior to CAIR becoming effective in 2009. CAIR has a limited provision for allowances for new units.

Mercury: In early 2004, EPA published a proposed rule to reduce mercury to a level of 21 X 10⁻⁶ lb/MWh from new units (about 2.0 lb/trillion Btu) and CPS agreed to this level for the new JKS 2 unit. The final rule was published in May 2005, called the Clean Air Mercury Rule, which established mercury emission limits on new and existing units and set up a cap-and-trade system starting in January 1, 2010. The final rule had a less stringent mercury limit for new units; however, CPS agreed to the previously proposed level and the final JKS 2 unit permit has a mercury limit (2.0 X 10⁻⁵ lb/MWh). The EPA goal is that emissions of mercury from power plants be reduced by 70.0% from today's levels and will result in a 15 ton cap nation-wide in 2018. The final rule also requires continuous mercury monitoring to be installed and operational by January 1, 2009.

Ozone: If a region of Texas has a level of ozone in the air that has surpassed a set level on multiple occasions during the year, the area is determined to be non-attainment for ozone, and the TCEQ must develop and implement a plan for the region as part of an EPA-approved State Implementation Plan. The EPA National Ambient Air Quality Standard for the San Antonio Metropolitan Area ("Area") for ozone is 0.08 parts per million ("ppm") averaged over an eight-hour period (instead of the previous one-hour standard of 0.12 ppm). Based on recent data, the Area has violated the eight-hour standard, causing the Area to be eligible to be designated as non-attainment for ozone. An Early Action Compact ("EAC")

was submitted to EPA by the Executive Committees of Alamo Area Council of Government as part of the Clean Air Plan for the four county Area including Bexar County. This effort allowed the Area to defer being declared non-attainment for the 8-hour ozone standard. In November 2006, the EPA officially deferred non-attainment for the four county Area until early 2008 pending outcome of the 2007 ozone season and the area must demonstrate compliance with the eight-hour ozone standard by December 31, 2007. Specific voluntary control strategies were implemented by December 31, 2005, and these control strategies were accepted by TCEQ and made part of the TCEQ's State Implementation Plan for ozone. Under the EAC, photochemical modeling is conducted, using proposed control strategies, to show achievement of the eight-hour standard by December 31, 2007. If the Area does not demonstrate compliance with the eight-hour ozone standard for ozone by the end of 2007 or fails to meet milestones in the EAC, the EPA will designate the Area as non-attainment for ozone. Should this happen, CPS power plants may be subject to increased NO_x reduction requirements, more than the CAIR limits, and have short-term NO_x limits imposed for the first time at some facilities. There will likely be increased restrictions on vehicle emissions and other small sources of NO_x, and volatile organic compounds such as painting activities and gasoline refueling. Designation of the Area as non-attainment by the EPA would also materially increase the cost of future CPS generation projects in the Area due to the imposition of tighter NO_x limits and the need to offset emissions of NO_x in the Area. The United States Supreme Court recently rendered its first major decision in the climate change arena. In *Massachusetts v. Environmental Protection Agency*, 549 U.S.____ (U.S. slip opinion released on April 2, 2007), the Supreme Court held that carbon dioxide and other greenhouse gases from motor vehicles are "air pollutants" subject to regulation under the Clean Air Act. At this time CPS cannot predict what legislation or administrative rules will be enacted by the EPA in response to this decision by the Supreme Court.

CPS, as one of the participants in the EAC, submitted a list of voluntary control strategies to help the Area achieve ozone attainment. These voluntary measures include planned reductions of NO_x emissions at CPS power plants, the purchase of alternative fueled vehicles, the continuation of CPS' "Mow Down Smog" program under which CPS provides rebates to purchasers of electric lawnmowers, and employee notifications of Air Quality Health Alert days.

Federal Clean Water Act

The National Pollutant Discharge Elimination System ("NPDES") program administered under the Federal Clean Water Act provides the framework for monitoring and regulating the discharge of any pollutant to surface waters of the United States. CPS has operated all of its generating facilities pursuant to water discharge permits from the State and NPDES permits from the EPA for many years with no significant compliance problems. The EPA delegated NPDES authority to the State, which implements a combined permit program on a "basin-wide" permitting basis.

Rulemaking by EPA concerning the Clean Water Act, Section 316(b) was designed to minimize the impact of power plant operations on fish. The rule may affect CPS' cooling lakes, Braunig and Calaveras. CPS will be required to meet the requirements of Section 316(b), which include requirements to reduce or minimize the impact of plant operations on fish in the lake. The specific ways CPS will comply with Section 316(b) are uncertain at this time because the rules are implemented by State regulatory agencies, which have discretion in compliance options. CPS utilizes treated sewage effluent and runoff waters rather than water from the Edwards Aquifer (the San Antonio area's primary source for potable water) to maintain operating levels at these man-made cooling lakes. For these water conservation efforts, the Association of Environmental Professionals selected CPS as one of eight 2001 recipients of the National Environmental Excellence Award.

Other Environmental Issues

By the early 1990's, CPS had completed a program aimed at removing from its system all electrical equipment accessible to the public that was known to contain polychlorinated biphenyls ("PCBs") in concentrations of 500 ppm or greater, as required by the Federal Toxic Substances Control Act. In addition, all oil-filled equipment is tested at the time of servicing as part of an ongoing program at CPS for voluntarily eliminating electrical equipment that contains mineral oil with any level of PCBs. Since 1996, in connection with capital improvements being made to many of its substation sites, CPS has identified and remediated areas found to be contaminated by pollutants, such as PCBs. The TCEQ allows the disposal of soil and debris contaminated with 1-49 ppm of PCBs from electrical equipment spills at a local landfill in lieu of distant disposal sites, at a considerable cost savings.

CPS also operates its own Class 1 non-hazardous waste landfill, which is registered with the TCEQ, an initiative that reduces disposal costs and CPS' reliance upon off-site disposal facilities. Since 1990, CPS has reduced the amount of hazardous waste (defined under the Federal Resource Conservation and Recovery Act) generated by its operations by about 90.0%.

CPS is currently planning to submit an air permit application to the TCEQ to construct new simple-cycle combustion turbines at the Braunig Lake site. These units will be similar to the peaking units at the Leon Creek plant with an estimated total capacity of approximately 200 MW. Based on current plans, these new units will use natural gas for fuel with back-up capacity to burn fuel oil. CPS plans to start construction on the new units in early 2008 and bring them in service in the summer of 2009.

CPS is scheduled to receive a Plantwide Applicability Limit ("PAL") permit soon for the Calaveras Lake plant facility. This PAL permit will set a cap on emissions at the site based on past emissions. This is a voluntary permit being submitted by CPS to provide flexibility to better manage facility-wide emissions. Once received, this PAL permit will allow CPS to have limited flexibility in maintaining its Calaveras Lake units while enhancing environmental protection. CPS' PAL permit application includes a commitment to maintain emission reductions that have been achieved in the past.

ENERGY CONSERVATION AND SAFETY PROGRAMS

CPS programs and activities to assist customers in understanding energy and ways to reduce electric and gas usage include:

- maintaining a special Energy Task Force telephone line where customers can obtain conservation and other energy-related information;
- conducting commercial energy audits;
- providing a \$15 coupon which can be redeemed for weatherization materials with each formal residential energy audit;
- continuing the "Cool Volunteers" program where CPS employees volunteer to weatherize more than 500 homes annually, as well as supporting other weatherization efforts throughout the community;
- assisting in calculating the size of residential air conditioning requirements;
- scheduling consumer information exhibits at high-traffic locations such as area shopping malls, trade shows, and other special events;
- conducting utility-related presentations for schools, community service organizations, and business and professional groups;
- mailing energy education materials and videos to schools upon request to supplement school curricula; and
- making available a residential self-energy audit video.

In connection with CPS' development of a Strategic Energy Plan, that includes energy efficiency as well as generation, CPS has developed a comprehensive, long-term energy efficiency plan. CPS will maintain, develop and implement programs and activities, alone and in collaboration with like-minded community entities, which will help achieve annual demand reduction targets that are indexed to the annual growth of electrical demand within the CPS service area. The goal is to achieve a peak demand reduction of 65 MW by January 31, 2016 through energy-efficiency programs. Current programs include Peak Saver, which cycles residential air conditioner compressors; residential rebates for both central air conditioners and window units; and commercial and industrial rebates for the installation of energy efficient air conditioners, motors, lighting, roof coatings and window film. CPS has committed to spend approximately \$30.0 million over five years to expand and enhance the long-term energy efficiency program with a peak demand impact goal of 10 MW in year five.

CPS' School Safety and Energy Education programs, which offer materials and services for students in kindergarten through the 12th grade, focus on timely topics such as the safe use of electricity and natural gas, energy conservation, utility careers, electric generation and transmission, and environmental issues. These materials and services can be used to supplement or update a school's current curriculum. Safety and energy education programs are available free of charge to all schools within the CPS service area. Consumer Relations representatives use a variety of videos, props, models, and other tools to illustrate the importance of safe and efficient use of electricity and natural gas. Teachers are provided with activity books to reinforce the message for follow-up lessons. Consumer Relations also maintains an energy education web portal at www.energywise.com, where educators, parents, and students can schedule programs and gain valuable information about gas and electricity.

The Public Safety Awareness Section ("PSA") provides electric and natural gas safety programs for all age groups. Since its inception in June 1986, the PSA has made 12,007 safety presentations to 1,976,953 contacts within the CPS service area and surrounding counties. During fiscal year 2006-07 the PSA provided 662 programs to 136,983 contacts. In addition to these public relation functions, the PSA works to provide natural gas incident programming with the affected public, government officials, emergency responders and excavators along CPS natural gas routes as required by the TRC and the Department of Transportation, Office of Pipeline Safety guidelines. The PSA works as a liaison with area educational, business, contractors, civic and emergency services organizations to establish strategic alliances that benefit the dissemination of CPS' natural gas and electric safety messages and enhance the utility's reputation as a good corporate citizen.

FUEL SUPPLY

CPS has a diversified generation fuel supply that includes coal, natural gas, nuclear, and fuel oil. CPS purchases natural gas for electric generation and local distribution through its natural gas system on a consolidated basis. Master enabling agreements with natural gas suppliers are reviewed on an ongoing basis to ensure adequate natural gas supplies exist to meet current and future requirements. While coal, natural gas, and nuclear fuel represent the base fuel supply for power generation, certain CPS power plants also have the capability to burn petroleum coke to supplement coal while others can burn fuel oil as an alternate fuel or to supplement natural gas. This dual fuel capability provides greater fuel flexibility. Fuel oil is used for start up and flame stabilization at the J.T. Deely Plant and can also be used for generation, when needed, at the O.W. Sommers and V.H. Braunig Plants.

Coal is CPS' base energy option, providing typically around 40% of its net annual generation. CPS' existing units and planned future unit are designed to use Wyoming Powder River Basin ("PRB") coal. PRB coal is clean, abundant and economical and it is part of CPS' long-range energy plan. Coal is secured through contracts providing both fixed and variable prices that reflect current market conditions. Delivery of PRB coal to CPS occurs on the Union Pacific ("UP") railroad with BNSF Railway having access rights to CPS' coal yard at Calaveras Lake. CPS has a favorable long-term contract with UP. Beginning the first calendar quarter of 2006, UP has improved its deliveries of PRB coal to CPS. While CPS will take every reasonable step to assure the continuity of its coal supply, CPS cannot predict whether any future coal shipment delays or curtailments could have a material adverse effect on the availability of its coal-fired generating stations.

Nuclear fuel procurement for STP is managed by the STP Nuclear Operating Company staff with oversight and guidance provided by the Participants. STP fuel supply requires uranium oxide, conversion of oxide to hexafluoride, enrichment of fissile uranium 235 isotope from 0.7% to about 4.5%, design and fabrication of fuel assemblies along with disposal of spent fuel assemblies. Uranium, conversion and enrichment are obtained under contracts of several years duration with primary producers. Beyond 2010, enrichment requirements are contracted with Urenco/LES, subject to NRC approval of Urenco/LES's license, through STP's current operating license term. Fabrication requirements are contracted with Westinghouse through STP's current operating license term. Spent fuel disposal is contracted with the DOE. Since the DOE has yet to open its spent fuel repository, the date by which it will start taking that fuel remains uncertain. The cost impact of continued storage of spent fuel on the STP site will remain uncertain until the date by which DOE will accept spent fuel has been established.

CPS also has high quality lignite reserves, including properties both owned and leased, in Lee and Bastrop Counties, Texas. CPS has leased these holdings for development and mining to the Aluminum Company of America, but retained ownership of the land, certain subsurface and other mineral rights, including an option to take lignite for its fuel needs. CPS has sold to SAWS certain water rights associated with these properties. CPS has negotiated sale of all interests in the lignite properties.

CPS owns and operates natural gas transmission facilities, consisting of two larger systems and some short segments connected to power plants. The North Gate Pipeline and the South Gate Pipeline are the two larger systems. The North Gate Pipeline is a 24-inch steel pipeline, which extends 17.2 miles from southern Comal County into northern Bexar County, Texas. Natural gas can be supplied to the pipeline through the 36-inch Oasis Pipeline and the 30-inch West Texas Pipeline.

The South Gate Pipeline comprises 60.3 miles of 24 and 30-inch steel pipeline, of which 46.9 miles of 30-inch pipeline extends south into Karnes County. A major delivery station in Karnes County connects to the joint-venture pipeline owned by Kinder Morgan and AEP TCC. CPS also operates numerous taps throughout the system connecting to Enterprise Texas Pipeline, L.P. ("Enterprise"), previously GulfTerra Energy Partners, L.P., on the North Gate and South Gate Pipelines, and directly into the supply pressure and distribution systems. CPS utilizes its diverse natural gas supply portfolio and interconnects with various pipelines to meet its power plant and distribution requirements.

CPS manages combined natural gas supply requirements of the power plants and distribution systems through a diversified portfolio of firm and interruptible services with a variety of pipelines, storage operators and suppliers. In accordance with the CPS Fuels Management Procedures Policy, designated CPS staff may enter into natural gas supply transactions using master enabling agreements, which incorporate standard commercial terms. CPS has approximately 60 master enabling contracts with natural gas suppliers under which CPS may purchase its natural gas requirements. CPS manages firm transport and storage contracts with Enterprise. In June 2006 Enterprise reported significant deterioration of the storage and delivery capability of their storage caverns. Repairs were completed to one of the caverns, and as of May 2007 CPS has access to approximately 60% of its contract capacity. Most of the major natural gas delivery stations are owned by CPS and remotely monitored by the CPS control center, assuring reliable operation.

Periods of prolonged cold weather, during which natural gas supply may fall short of demand, may necessitate the curtailment of gas use for boiler fuel. The Natural Gas Policy Act subjects intrastate gas, including gas intended for boiler fuel use, to Presidential emergency purchase authority and emergency allocation authority to assist in meeting interstate natural gas requirements for high priority uses. CPS' gas supply has not been curtailed by its major suppliers since 1983. Nevertheless, CPS' gas supply is subject to the ability of its gas suppliers to acquire sufficient quantities of supply, as well as fluctuations in market prices.

CPS maintains fuel oil supplies at certain capable generating units. Depending on the unit, fuel oil may be used for startup, supplemental or primary fuel. CPS maintains inventory onsite and delivery capability at these plants to assure continued operation during natural gas supply disruptions or price events.

The Energy Price Risk Management Policy was implemented in 2002 to reduce the effects of energy price volatility consistent with this policy. At times, financial derivative instruments are utilized to hedge natural gas prices. See "WHOLESALE POWER MARKETING" and "RISK MANAGEMENT" herein.

On June 21, 2007, CPS entered into a prepaid natural gas transaction with SA Energy Acquisition Public Facility Corporation ("PFC"), a non-profit public facility corporation previously created by the City pursuant to Chapter 303, as amended, Texas Local Government Code. This transaction enabled CPS to purchase a 20 year supply of natural gas to cover approximately 20,000 MMBtu per day on an annual basis. This gas is dedicated for use in CPS' gas distribution system and CPS' obligation in this transaction is limited to a take-and-pay gas purchase agreement, obligating CPS to pay a monthly index-based price less a fixed discount for delivered gas. The PFC prepaid for this gas by issuing \$644,260,000 of tax-exempt fixed rate bonds and used the proceeds to make the payment to the natural gas supplier. This prepaid gas transaction was supported by its own official statement issued by the PFC fully disclosing the transaction and related risks.

POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS

The Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006, added section 4965 ("Section 4965") to the Internal Revenue Code, as amended ("Code"), which imposes an excise tax with respect to "prohibited tax shelter transactions" on certain "tax-exempt entities," including a state or political subdivision thereof, such as the City that is a "party to a prohibited tax shelter transaction". CPS, acting for the benefit of the City, entered into a series of leasing transactions ("Transactions") in 2000, which may be considered prohibited tax shelter transactions.

When initial guidance on Section 4965 was released, CPS calculated its potential tax liability under various scenarios. It determined, at least under one reading of the Code, that this liability could be as much as \$12 million for excise taxes in 2007. However, subsequent clarification of the regulations and rules implementing Section 4965 and additional guidance from the United States Department of the Treasury ("Treasury") may remove any going forward excise tax liability for CPS or the City.

The Internal Revenue Service ("IRS") published Notice 2007-18 on February 26, 2007 (the "Notice") which, while it left many questions unanswered, provided certain interim guidance regarding the definition of the term "party to a prohibited tax shelter transaction" and the appropriate treatment of net income or proceeds received prior to the effective date of Section 4965. On July 6, 2007, the Treasury published Proposed Treasury Regulations, Temporary Treasury Regulations, and Temporary and Final Treasury Regulations interpreting Section 4965 and related Code sections (collectively, "New Regulations"). The New Regulations provide guidance that enables CPS to determine whether the City has Section 4965 tax liability related to the Transactions, including defining the terms "net income" and "proceeds," providing rules for proper allocation of net income and proceeds to periods before and after the effective date of Section 4965, exempting from Section 4965 excise taxes of net income and proceeds allocated to periods before the effective date of Section 4965, providing examples, and providing additional guidance regarding disclosure and filing requirements. CPS is in the process of determining whether, in light of this new guidance, it has any tax liability under Section 4965. Initial analysis of the New Regulations suggests that the City would not owe any excise taxes with respect to the Transactions and would not be required to file a tax return for fiscal year ending in 2007 or in subsequent years. Since the substantive rules of the New Regulations are contained in Proposed Treasury Regulations, the Treasury may make changes in the Final Treasury Regulations that adversely affect the liability of the City under Section 4965. CPS and its advisors will continue to analyze the New Regulations and any future guidance to assess the City's potential Section 4965 tax liability.

LITIGATION

The City of San Antonio

This paragraph describes the litigation involving the City that does not directly involve CPS or claims payable out of Systems revenues, please see "LITIGATION – Systems Litigation and Claims" for a description of litigation involving CPS. The City is a defendant in various lawsuits and is aware of pending claims arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. That litigation includes lawsuits claiming damages that allege that the City caused personal injuries and wrongful deaths; class actions and promotional practices; various claims from contractors for additional amounts under construction contracts; and property tax assessments and various other liability claims, including workers' compensation claims and EEOC claims. The amount of damages in most of the pending lawsuits is capped under the Texas Tort Claims Act at \$250,000; therefore, the potential liability is approximated at \$12.6 million as of May 2, 2007. The amount of \$19.2 million is included as a component of the City's reserve for claims liability. The estimated liability, including an estimate of incurred but not reported claims, is recorded in the City's Insurance Reserve Fund. The status of such litigation ranges from early discovery stage to various levels of appeal of judgments both for and against the City. The City intends to defend vigorously against the lawsuits, including the pursuit of all appeals; however, no prediction can be made, as of the date hereof, with respect to the liability of the City for such claims or the outcome of such lawsuits.

In the opinion of the City Attorney, it is improbable that the lawsuits now outstanding against the City could become final in a timely manner so as to have a material adverse financial impact upon the City.

Systems Litigation and Claims

CPS is involved in various legal proceedings related to alleged personal and property damages, condemnation appeals, property tax assessments appeals, and discrimination cases. On August 25, 2006, CPS was sued by its former Senior Vice President and General Counsel for alleged violations of the Texas Whistleblower Act (including claims that certain City and CPS actions violated the Bond Ordinances), sex discrimination, and retaliation for reporting sex discrimination. CPS has entered into an agreement settling all claims asserted in this suit. CPS maintains a litigation reserve that is sufficient to satisfy this settlement and reasonable outcomes concerning all other pending litigation against CPS.

The City of San Antonio has delegated to the Systems the authority to condemn property in order to erect a 345Kv transmission line between the Cagnon and Kendall substations, a 138Kv line between the Texas Research and Medina Lake substations, together with a new substation, and a 138Kv line between the Cagnon and Lytle substations, together with a new substation ("Transmission Projects"). Certain landowners with easements along the routes for these Transmission Projects have brought suit to determine the value of property easements being acquired through condemnation. In the aggregate, the cost of these property easements could be as much as several million dollars. Since the reasonable costs associated with acquisition of property for the Transmission Projects may be eventually recovered from ERCOT ratepayers through transmission cost of service proceedings, see "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation" herein, CPS has not made an adjustment in its litigation reserve to address the potential liabilities associated with the Transmission Projects.

WHOLESALE POWER MARKETING

Beginning in 1997, CPS initiated an active program to market its excess generation capacity in the wholesale power market. CPS' power marketing strategy also includes purchasing power if the cost of such power is below what it would cost for CPS to supply the energy from its own generation units. CPS may also purchase power if there is an unanticipated deficit in capacity, to maintain planning reserve margins, or to enhance reliability for the electric system. CPS buys power only for CPS customer load requirements and does not sell power in excess of its available generation capacity. CPS' sales and purchase volumes represent less than 10% of CPS' generation volumes.

Trained, experienced staff in CPS' Wholesale Energy Markets Division, who report to the CPS Executive Vice President for Energy Development, conduct wholesale power marketing transactions. Any deviation from current operating procedures related to purchases or sales of energy must be reported to management and, depending on the deviation, also to the Board.

CPS conducts wholesale power marketing transactions only with approved counterparties with which CPS has established master Enabling Agreements for such transactions. The enabling agreements outline the general payment and delivery terms and conditions of such sales and purchases, and provide for written transaction confirmations to be exchanged between CPS and its counterparts for each transaction.

RISK MANAGEMENT

In June 1998, CPS established a Risk Management Department under the direction of the Executive Vice President and Chief Financial Officer. The Risk Management Department works closely with the Wholesale Energy Markets staff and provides credit risk assessments of existing and potential counterparties. Capabilities in this area have continued to expand. In April 2006, a Chief Risk Officer was brought on board to monitor financial and other risks for CPS, and the department was renamed Enterprise Risk Management.

As part of its risk management and fuel and electricity purchasing policies, CPS has the capability to utilize certain derivative financial instruments, such as energy-based futures, options and swap contracts to hedge or mitigate price volatility associated with fuel and energy sales and purchases. The program is operated in accordance with a written policy approved by the Board. A program oversight committee composed of CPS corporate officers and senior executives approves operating policies and corporate hedging strategies.

INVESTMENTS

Operating Funds

CPS invests its operating funds as authorized by its bond and commercial paper ordinances and by federal and Texas law including, but not limited to, the Public Funds Investment Act, as amended, Chapter 2256, Texas Government Code ("Investment Act"), Chapter 272, as amended, Texas Local Government Code, and in accordance with written investment policies approved by the Board. These ordinances, laws and CPS' investment policies are subject to change.

Under current Texas law and the investment policies approved by the Board, CPS may invest its funds in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued by a Federal agency or instrumentality of the United States; (4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by Texas or the United States or their agencies and instrumentalities; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated not less than "A" or its equivalent; (6) a certificate of deposit or share certificate which is fully secured and/or federally insured; (7) securities lending programs that are 100-102% collateralized; (8) fully collateralized repurchase agreements; (9) certain bankers' acceptances; (10) commercial paper rated not less than "A-1" or "P-1" or equivalent and that have a stated maturity of 270 days or fewer from the date of issuance; (11) no-load money market mutual funds that have a dollar weighted average stated maturity of 90 days or less; and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share; (12) certain no-load mutual funds that are rated at least "AAA" or its equivalent; (13) certain guaranteed investment contracts that are funded by bond proceeds if authorized in the order, ordinance, or resolution authorizing the issuance of the bonds; (14) investment pools that stabilize at a \$1 net asset value to the extent reasonably possible and are rated no lower "AAA" or "AAA-m" or equivalent; (15) in connection with a transaction authorized by Section 272.004 of the Local Government Code, one or more of the investments, securities, guarantees, and/or insurance contracts or other contracts and agreements described in Section 452.108(d) of the Texas Transportation Code, including, but not limited to the following: payment agreements, financial guarantees or insurance contracts with counterparties having either a corporate credit or debt rating in any form, a claims-paying ability, or a rating for financial strength of "AA" or better and (16) hedging instruments authorized by Section 2256.0201 of the Texas Government Code and in accordance with CPS' Energy Price Risk Management Policy for the purpose of managing risks of financial uncertainty or loss associated with adverse volatility in the pricing of CPS' energy and fuel assets, to include energy based futures contracts, option contracts, swap contracts, insurance contracts, and structured contracts composed of combinations of hedging instruments.

CPS is specifically prohibited from investing its funds in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the change in the market index.

The weighted term to maturity of investments at January 31, 2007 was 141 days for operating and construction funds. CPS' operating and construction funds, as of January 31, 2007, were invested entirely in United States Government or Government Agency Obligations held in book-entry form by the Federal Reserve, in money market mutual funds, or in money market deposit accounts. Investments at amortized cost were \$1.190 billion and at market value were \$1.190 billion at January 31, 2007. Based on principal cost, 96% are invested in United States Government Agency Obligations, and 4% in money market mutual funds, and in money market deposit accounts. CPS determines the market value of such investments by reference to published quotations, dealer bids, and comparable information. No CPS funds are invested currently in reverse repurchase agreements or derivative securities, securities whose rate of return is determined by reference to some other instrument, index, or commodity, except for certain natural gas options held under the Energy Price Risk Management Policy. See "WHOLESALE POWER MARKETING", "RISK MANAGEMENT" and "FUEL SUPPLY".

STP Decommissioning Funds

CPS invests the funds in two specific decommissioning trusts, the STP Decommissioning Trust and the Master Trust (TCC Funded), in accordance with its decommissioning investment policy and as authorized by Texas law, the NRC and, where applicable, the PUCT. The STP Decommissioning Trust is the sinking fund created by CPS for the sole purpose of financing the decommissioning expenses for its original interest in STP. CPS obtained the Master Trust (TCC Funded) after it purchased from AEP Texas Central Company, an additional interest in STP. As part of the acquisition of the additional interest in STP, CPS obtained a proportionate amount of the nuclear decommissioning trust fund originally created by TCC. Responsibility for continuous funding of the Master Trust (TCC Funded) will remain the responsibility of TCC customers through final decommissioning of STP. At acquisition by CPS of the additional interest in STP from TCC, the funds were transferred to CPS by TCC and placed into the Master Trust (TCC Funded), which is entirely separate from the existing decommissioning trust fund held in the STP Decommissioning Trust created and maintained by CPS for its original interest in STP. See "DESCRIPTION OF PHYSICAL PROPERTY – ELECTRIC SYSTEM - South Texas Project" for further discussion of CPS' acquisition of a 12% interest in STP from TCC. CPS' investments in the STP Decommissioning Trust and in the Master Trust (TCC Funded) are held by an independent trustee and are invested pursuant to a separate investment policy adopted by the Board and to the provisions of the trust agreements of each trust.

Effective September 1, 2005, the Investment Act was amended to allow a Texas municipality which owns a municipal electric utility to invest its decommissioning trust funds in any investment authorized by Subtitle B, Title 9 of the Texas Property Code. The broad investment authority found in the Texas Property Code includes, but is not limited to, the power to invest in equities.

Under the Property Code, other applicable law and the South Texas Project Decommissioning Trust Investment Policy ("STP Investment Policy") approved by the Board, the STP Decommissioning Trust may be invested as follows: (1) funds may be invested in investments permissible by law under the guidance and regulations issued by the NRC and under the Texas Property Code; (2) the STP Decommissioning Trust's investments should be diversified such that (a) no more than 5.0% of the securities held may be issued by one entity, with the exception of the federal government, its agencies and instrumentalities, and (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investment trusts diversified as to geographic region; (3) derivative securities are limited to those whose purpose is to enhance returns of the STP Decommissioning Trust without a corresponding increase in risk of the portfolio; (4) securities lending transactions must be collateralized at 100-102%; (5) fixed income securities may not be rated below "BBB-" by Standard & Poor's Ratings Services ("S&P") and Fitch Ratings or "Baa3" by Moody's Investors Service, Inc. ("Moody's"), at the time of purchase, and the overall fixed income portfolio must be rated no less than "A" by S&P, Fitch Ratings and Moody's; (6) equity securities are permissible investments (a) limited to a cap of (i) 60% when the weighted average remaining life of the decommissioning liability exceeds 5 years, (ii) 30% when the weighted average remaining life of decommissioning liability ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) when the equities are of a type not considered to be speculative; and (7) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds are permissible investments, if the commingled funds are consistent with the goals stated in the STP Investment Policy. Commingled funds (a) may be focused on specific market sectors or concentrated in a few holdings only as necessary to balance the trust's overall investment portfolio mix, and (b) may contain some below investment grade bonds; but the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below an "A" rating by S&P or an "A" by Moody's.

The STP Decommissioning Trust is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal

debt securities that have a bond rating below investment grade (below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade after the debt security has been purchased; and (4) from investing in equity securities that are considered speculative (e.g., stocks of companies with limited operating history or that have low "safety" rankings from ratings agencies).

Investments in the STP Decommissioning Trust consisted of fixed income securities, equity securities and cash equivalents at January 31, 2007. The total market value of all investments was \$254.9 million. Fixed income securities totaled \$117.4 million and had an average duration to maturity of 4.48 years. Based upon market value, the fixed income securities were 65% United States Government and Government Agency Obligations, and 35% Corporate and Municipal Bonds. Equity securities had a market value of \$127.6 million. The remaining \$9.9 million of market value was held in cash, cash equivalents, collateral and accrued income.

Master Trust (TCC Funded)

Under applicable law, including NRC and PUCT regulations, and the STP Investment Policy, the Master Trust (TCC Funded), may be invested in (1) a way that, once the portfolio of securities (including commingled funds) held in the Trust contains securities with an aggregate value in excess of \$20 million, the funds are diversified so that (a) no more than 5.0% of the Investment Manager's portfolio of securities held are issued by one entity, with the exception of the federal government, its agencies and instrumentalities, (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investments diversified as to geographic region; (2) derivative securities limited to those whose purpose is to enhance returns of the trust without a corresponding increase in risk of the portfolio; (3) securities lending transactions when collateralized at 100-102%; (4) fixed income securities not rated below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's, at the time of purchase; (5) equity securities, (a) limited to a cap of (i) 60.0% when the weighted average remaining life of the decommissioning liability exceeds 5 years, (ii) 30.0% when the weighted average remaining life ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0.0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) with at least 70.0% of the aggregate market value of the equity portfolio, including the individual securities in commingled funds, having a quality ranking from a major rating service and the overall portfolio of ranked equities with a weighted average quality rating equivalent to the composite rating of the S&P 500 index assuming equal weighting of each ranked security in the index; and (6) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds that (a) are consistent with the goals stated in the investment policy, (b) are focused on specific market sectors or concentrated in a few holdings only if used as necessary to balance the trust's overall investment portfolio mix, and (c) may contain some below investment grade bonds; however, the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below a "AA" rating by S&P or a "Aa2" by Moody's.

The Master Trust (TCC Funded) is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal debt securities that have a bond rating below investment grade (below "BBB-" by S&P and Fitch Ratings or "Baa3" by Moody's) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade at some time after the debt security has been purchased; (4) from investing in equity securities where the issuer has a capitalization of less than \$100 million; and (5) from investing in securities issued by the electric utility collecting the funds or any of its affiliates; however, investments may include commingled funds that contain securities issued by the electric utility if the securities of the utility constitute no more than 5.0% of the fair market value of the assets of such commingled funds at the time of the investment.

At January 31, 2007, CPS' investments in the Master Trust (TCC Funded) consisted of fixed income securities, equity securities and cash equivalents with a total market value of \$82.2 million. The fixed income securities totaled \$31.7 million with an average duration to maturity of 4.6 years. Based upon market values, 70% of these fixed income securities were invested in United States Government and Government Agency obligations, 14% in Municipal Bonds, and 16% in Corporate Bonds. Investment in equity securities represented a market value of \$50.1 million. The remaining \$0.4 million in market value consisted on Cash, Cash Equivalents and accrued income.

Investment Policies

Under the Investment Act, CPS is required to invest its funds in accordance with written investment policies that (1) primarily emphasize safety of principal and liquidity; (2) address investment diversification, yield, maturity, and the quality and capability of investment management; (3) include a list of authorized investments for CPS funds and the maximum allowable stated maturity of any individual investment; (4) state the maximum average dollar-weighted maturity allowed for pool fund groups; (5) contain the methods to monitor the market price of investments acquired with public funds; and (6) require the settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis. All CPS funds must be invested consistent with formally adopted written investment strategies that specifically address each fund's investment. Each strategy describes its objectives concerning (1) suitability of investment type; (2) preservation and safety of principal; (3) liquidity; (4) marketability of each investment; (5) diversification of the portfolio; and (6) yield.

Under the Investment Act, CPS investments under all investment policies must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived."

Consistent with the requirements of the NRC, Texas Property Code, the Investment Act, and as applicable, the PUCT, the STP Decommissioning Trust, and the Master Trust (TCC Funded) will be invested consistent with the following goals: (1) the funds will be invested with a goal of earning a reasonable return commensurate with the need to preserve the value of the assets; (2) the portfolio of securities will be diversified to the extent reasonably feasible given the size of the trust; (3) asset allocation and the acceptable risk level of the portfolio will take into account market conditions, the time horizon remaining before the commencement and completion of decommissioning, and the funding status of the trust; (4) while maintaining an acceptable risk level, the investment emphasis when the remaining life of the liability exceeds five years will be to maximize net long-term earnings and the investment emphasis in the remaining investment period of the trust will be on current income and asset preservation; and (5) in selecting investments, the impact of the investment on the portfolio's volatility and expected return net of fees will be considered.

Additional Provisions

Under the Investment Act for the Operating Funds, STP Decommissioning Trust and the Master Trust (TCC Funded), CPS must: (1) review annually and, if desired, change its adopted written investment policies and strategies; (2) designate investment officers to be responsible for investment of its funds consistent with the investment policies of CPS; (3) require any investment officers with personal business relationships or relatives with firms seeking to sell securities to the entity to disclose the relationship and file a statement with the Texas Ethics Commission and the Board; (4) require the qualified representative of firms seeking to sell securities to CPS to (a) receive and review the CPS investment policies; (b) acknowledge that reasonable controls and procedures have been implemented to preclude investment transactions not authorized by the CPS investment policies; and (c) deliver a written statement attesting to these requirements; (5) perform an annual audit of the management controls on investments and adherence to the CPS investment policies; (6) provide specific investment training for CPS' investment officers; and (7) review, revise, and adopt on an annual basis a list of qualified brokers that are authorized to engage in investment transactions with CPS.

For the STP Decommissioning Trust and the Master Trust (TCC Funded), CPS is prohibited from being engaged as investment manager for the funds or from giving day-to-day management direction of the funds' investments. Therefore, the use of one or more professional investment managers is necessary to assure that the trusts are managed in a manner so that the funds are secure and earn a reasonable return. CPS has the following duties concerning the use of one or more investment managers: (1) a duty to determine whether the investment manager's fee schedule for investment management services is reasonable, when compared to other such managers; (2) a duty to investigate and determine whether the past performance of the investment manager in managing investments has been reasonable; (3) a duty to investigate and determine whether the financial stability and strength of the investment manager is adequate for purposes of liability; (4) a duty to investigate and determine whether the investment manager has complied with the investment management agreement; and (5) a duty to investigate any other factors which may bear on whether the investment manager is suitable.

Some of the proceeds of the financial lease/leaseback transaction with a subsidiary of Unicom Corporation involving CPS' J.K. Spruce Unit 1 are invested, as security for certain CPS undertakings in connection with the transaction, in a collateralized payment undertaking agreement among (1) CPS; (2) Spruce Equity Holdings, L.P., a Delaware limited partnership; (3) Spruce Holdings Trust, a Delaware business trust; and (4) a subsidiary of American International Group, Inc. Unicom Corporation, subsequent to this transaction, has merged into Exelon Corporation. See "POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS" herein.

TAX MATTERS

Tax Exemption

The delivery of the Notes is subject to the opinion of Bond Counsel to the effect that interest on the Notes for federal income tax purposes (1) is excludable from the gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date hereof ("Code"), of the owners thereof pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The statute, regulations, rulings, and court decisions on which such opinion is based are subject to change. The form of the opinion of Bond Counsel is attached hereto as Appendix A.

Interest on all tax-exempt obligations, including the Notes, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate investment trust (REIT), a financial asset securitization investment trust (FASIT), or a real estate mortgage investment conduit (REMIC). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code will be computed.

In rendering the foregoing opinions, Bond Counsel will rely upon representations and certifications of the City and the Board made in a certificate of even date with the initial delivery of the Notes pertaining to the use, expenditure, and investment of the proceeds of the Notes and will assume continuing compliance with the provisions of the Ordinance by the City and the Board subsequent to the issuance of the Notes. The Ordinance contains covenants by the City and the Board with respect to, among other matters, the use of the proceeds of the Notes and the facilities and equipment financed or refinanced therewith by persons other than state or local governmental units, the manner in which the proceeds of the Notes are to be invested, if required, the calculation and payment to the United States Treasury of any "arbitrage profits" and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants may cause interest on the Notes to be includable in the gross income of the owners thereof from the date of the issuance of the Notes.

Except as described above, Bond Counsel will express no other opinion with respect to any other federal, state or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Notes. Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the City and the Board described above. No ruling has been sought from the Internal Revenue Service ("IRS") with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the IRS. The IRS has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Notes is commenced, under current procedures the IRS is likely to treat the City as the "taxpayer", and the owners of the Notes would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Notes, the City may have different or conflicting interests from the owners of the Notes. Public awareness of any audit of the Notes could adversely affect the value and liquidity of the Notes during the pendency of the audit, regardless of its ultimate outcome.

Ancillary Tax Consequences

Prospective purchasers of the Notes should be aware that the ownership of tax-exempt obligations such as the Notes may result in collateral federal tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Tax Accounting Treatment of Discount Notes

The initial public offering price to be paid for certain Notes may be less than the amount payable on such Notes at maturity ("Discount Notes"). An amount equal to the difference between the initial public offering price of a Discount Note (assuming that a substantial amount of the Discount Notes of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Notes. A portion of such original issue discount, allocable to the holding period of a Discount Note by the initial purchaser, will be treated as interest for federal income tax purposes, excludable from gross income on the same terms and conditions as those for other interest on the Notes. Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Note, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Note and generally will be allocated to an initial purchaser in a different amount from the amount of the payment denominated as interest actually received by the initial purchaser during his taxable year.

However, such accrued interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by section 55 of the Code, and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

In the event of the sale or other taxable disposition of a Discount Note prior to maturity, the amount realized by such owner in excess of the basis of such Discount Note in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Note was held) is includable in gross income.

Owners of Discount Notes should consult with their own tax advisors with respect to the determination for federal income tax purposes of accrued interest upon disposition of Discount Notes and with respect to the state and local tax consequences of owning Discount Notes. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on the Discount Notes may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

Tax Accounting Treatment of Premium Notes

The initial public offering price to be paid for certain Notes may be greater than the stated redemption price on such Notes at maturity ("Premium Notes"). An amount equal to the difference between the initial public offering price of a Premium Note (assuming that a substantial amount of the Premium Notes of that maturity are sold to the public at such price) and its stated redemption price at maturity constitutes premium to the initial purchaser of such Premium Notes. The basis for federal income tax purposes of a Premium Note in the hands of such initial purchaser must be reduced each year by the amortizable note premium, although no federal income tax deduction is allowed as a result of such reduction in basis for amortizable note premium with respect to the Notes which are Premium Notes. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Note. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity.

Purchasers of the Premium Notes should consult with their own tax advisors with respect to the determination of amortizable note premium on Premium Notes for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Premium Notes.

RATINGS

Fitch Ratings, Moody's Investors Service, Inc., and Standard & Poor's Ratings Services, have each affirmed the following unenhanced ratings assigned to CPS' outstanding Senior Lien Obligations, Junior Lien Obligations and Commercial Paper:

	Ratings at January 31, 2006		
	Senior Lien Debt	Junior Lien Debt	TECP
Fitch Ratings	AA+	AA+ / F1+	F1+
Moody's Investors Service, Inc.	Aa1	Aa2 / VMIG 1	P-1
Standard & Poor's Ratings Services	AA	AA- / A-1+	A-1+

An explanation of the significance of such ratings may be obtained from the company furnishing such rating. The ratings reflect only the respective views of such organizations, and the City or the Board makes no representation as to the appropriateness of the ratings. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such rating companies, if in the judgment of such companies, circumstances so warrant. Any such downward revision or withdrawal of any such ratings may have an adverse effect on the market price of the Notes.

AVAILABLE INFORMATION

CPS is not required to file reports with the Securities and Exchange Commission but will make available upon request copies of its most recent Annual Report, Offering Memorandum and Official Statements. Further and more complete information concerning the Systems is contained in the most recent official statement of the City pertaining to its electric and gas system debt. Requests for information may be directed to CPS Energy, Financial Services, Mail Drop 100602, Post Office Box 1771, San Antonio, Texas 78296-1771.

Disclosure of Information

The offering of the Notes is exempt from the continuing disclosure and material event notice requirements of SEC Rule 15c2-12 ("Rule") pursuant to paragraph (d)(ii) of the Rule, because (1) the Notes are in authorized denominations of \$100,000 or more, and (2) the Notes have a maturity of nine months or less. Accordingly, the Board will not contract to provide continuing information to investors after it issues the Notes. However, in connection with its Senior Lien Obligations and Junior Lien Obligations, CPS does file continuing disclosure information on an annual basis with the Municipal Advisory Council of Texas, an approved State Information Depository ("SID") and each Nationally Recognized Municipal Securities Information Repository ("NRMSIR").

The Municipal Advisory Council of Texas ("MAC") has been designated by the State and approved by the SEC staff as a qualified SID. The address of the MAC is 600 West 8th Street, Post Office Box 2177, Austin, Texas 78768-2177, and its telephone number is 512/476-6947. The MAC has also received SEC approval to operate, and has begun to operate, a "central post office" for information filings made by municipal issuers, such as the City. A municipal issuer may submit its information filings with the central post office, which then transmits such information to the NRMSIRs and the appropriate SID for filing. This central post office can be accessed and utilized at www.DisclosureUSA.org ("DisclosureUSA"). The Board has begun utilizing DisclosureUSA for the filing of information relating to the Senior Lien Obligations and the Junior Lien Obligations.

Under Texas law, including, but not limited to, Chapter 103, Texas Local Government Code, as amended, and Chapter 1502, Texas Government Code, as amended, the Board must keep its fiscal records in accordance with generally accepted accounting principles, must have its financial accounts and records audited by a certified public accountant, and must file each audit report with the City Clerk within 120 days after the close of the City's or Board's fiscal year. The Board's fiscal records and audit reports are available for public inspection during the regular business hours of the City Clerk. Additionally, upon the filing of these financial statements and the annual audit, these documents are subject to the Public Information Act, Chapter 552, Texas Government Code, as amended. Thereafter, any person may obtain copies of these documents upon submission of a written request to the City Clerk, and upon paying the reasonable copying, handling, and delivery charges for providing this information.

This Notice is being provided by CPS, pursuant to the requirement of the Rule, as notification regarding the filing of annual financial information pursuant to paragraph (b)(5)(i)(D) of the Rule.

The Systems became obligated to make annual disclosure of certain financial information by filing with the SID and each NRMSIR in 1996. All financial information has been filed in a timely manner.

MISCELLANEOUS

NO DEALER, BROKER, SALESMAN, OR OTHER PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED IN THIS COMMERCIAL PAPER OFFERING MEMORANDUM OR THE MOST RECENT OFFICIAL STATEMENT WITH RESPECT TO THE SYSTEMS OF THE CITY IN CONNECTION WITH THE OFFERING DESCRIBED HEREIN, AND IF GIVEN OR MADE, SUCH OTHER INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED. THIS COMMERCIAL PAPER OFFERING MEMORANDUM DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE SECURITIES OFFERED HEREBY, NOR SHALL THERE BE ANY OFFER OR SOLICITATION OF SUCH OFFER OR SALE OF SECURITIES IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSON TO MAKE SUCH OFFER, SOLICITATION, OR SALE. NEITHER THE DELIVERY OF THIS COMMERCIAL PAPER MEMORANDUM NOR THE SALE OF ANY OF THE SECURITIES IMPLIES THAT THE INFORMATION HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO THE DATE HEREOF. THE INFORMATION CONTAINED HEREIN HAS BEEN OBTAINED FROM THE CITY'S OFFICIAL STATEMENT, PUBLISHED SOURCES, AND OTHER DATA FURNISHED BY THE CITY. THE DEALER MAKES NO REPRESENTATION AND ACCEPTS NO LIABILITY AS TO EITHER THE ACCURACY OR COMPLETENESS OF THE INFORMATION HEREIN. ADDITIONAL COPIES OF THIS COMMERCIAL PAPER MEMORANDUM MAY BE REQUESTED FROM YOUR DEALER REPRESENTATIVE, CITIGROUP GLOBAL MARKETS INC. (212) 723-5594; OR J.P. MORGAN SECURITIES INC. (212) 834-7175.

The Dealers have provided the following sentence for inclusion in this Offering Memorandum. The Dealers have reviewed the information in this Offering Memorandum in accordance with their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Dealers do not guarantee the accuracy or completeness of such information. The date of this Commercial Paper Offering Memorandum is September 7, 2007.

APPENDIX A



CPS ENERGY

FORM OF OPINION OF BOND COUNSEL

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Fulbright & Jaworski L.L.P.

A Registered Limited Liability Partnership
300 Convent Street, Suite 2200
San Antonio, Texas 78205-3792
www.fulbright.com

telephone: (210) 224-5575

facsimile: (210) 270-7205

WE HAVE ACTED AS BOND COUNSEL for the City of San Antonio, Texas, a municipal corporation of the State of Texas (the "City"), in connection with the issue of commercial paper notes (the "Notes") described as follows:

CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A, in an aggregate principal amount not to exceed \$350,000,000 (the "Notes"); issuable in fully registered form only, in denominations of \$100,000 principal amount, or in \$1,000 integrals greater than \$100,000; dated the dates, bearing interest, maturing on the dates and principal amounts, and transferable and exchangeable as set out in the Notes and in the ordinance authorizing their issuance (the "Ordinance").

WE HAVE ACTED as bond counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Notes under the Constitution and laws of the State of Texas and with respect to the status of the interest on the under federal income tax law. In such capacity we have examined relevant provisions of the Constitution and laws of the State of Texas and of federal income tax law; a transcript of certain certified proceedings of the City Council of the City pertaining to the issuance of the Notes; certain certifications and representations, as hereinafter described, and other material facts within the knowledge and control of the City and the City Public Service Board of San Antonio, Texas (the "Systems"), upon which we rely; and certain other customary documents and instruments authorizing and relating to the issuance of the Notes, including the forms of Note to be executed and delivered by the City from time to time. We have not been requested to examine, and have not investigated or verified, any original proceedings, records, data, or other material, but have relied upon the transcript of certified proceedings. We have not assumed any responsibility with respect to the financial condition or capabilities of the City or the Systems or the disclosure thereof in connection with the sale of the Notes. We express no opinion and make no comment with respect to the sufficiency of the security for or the marketability of the Notes. Capitalized terms not otherwise defined herein shall have the meanings assigned to such terms in the Ordinance. Our role in connection with the City's Offering Memorandum prepared for use in connection with the sale of the Notes has been limited as described therein.

BASED ON SUCH EXAMINATION, it is our opinion that the transcript of certified proceedings evidences legal authority for the issuance of the Notes in full compliance with the Constitution and laws of the State of Texas presently in effect; the Notes, when authenticated and delivered to and paid for by the initial purchasers of the Notes, will be valid and legally binding special obligations of the City enforceable in accordance with the terms and conditions thereof, except to the extent that the enforcement of the rights and remedies of the owners thereof may be limited by laws relating to bankruptcy, insolvency, reorganization, or moratorium or other similar laws affecting the rights of creditors, or the exercise of judicial discretion in accordance with general principles of equity; the Notes have been authorized in accordance with law; and the Notes are payable from and equally secured by a lien on and pledge of (i) the proceeds from (a) the sale of a series or issue of Bonds hereafter issued and to be used to pay outstanding Notes and (b) the sale of Notes issued pursuant to the Ordinance to refund outstanding Notes, (ii) borrowings under and pursuant to a Credit Agreement providing credit to the City under the terms and conditions set forth therein, (iii) the Net Revenues of the Systems, such lien on and pledge of the Net Revenues, however, being subordinate to the prior and superior lien and pledge securing the payment of the currently outstanding Senior Lien Obligations and Junior Lien Obligations and any Additional Senior Lien Obligations, Additional Junior Lien Obligations or Prior Lien Bonds hereafter issued, and (iv) amounts in certain funds established pursuant to the Ordinance.

THE OWNERS OF NOTES shall never have the right to demand payment thereof out of any funds raised or to be raised by ad valorem taxation, or from any source whatsoever other than as specified above.

IT IS FURTHER OUR OPINION, based upon the foregoing, that pursuant to section 103 of the Internal Revenue Code of 1986, as amended and in effect on the date hereof (the "Code"), and existing regulations, published rulings, and court decisions thereunder, and assuming continuing compliance with the provisions of the Ordinance and in reliance upon representations and certifications of the City made in a certificate of even date herewith pertaining to the use, expenditure, and investment of the proceeds of the Notes, when the Notes are authenticated and delivered to and

Legal Opinion of Fulbright & Jaworski L.L.P. in connection with the authorization and issuance of "CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS COMMERCIAL PAPER NOTES, SERIES A"

paid for by the initial purchasers thereof, interest on the Notes (1) will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as described below, corporations, for federal income tax purposes.

WE CALL TO YOUR ATTENTION THAT, with respect to our opinion in clause (2) above, interest on all tax-exempt obligations, such as the Notes, owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate mortgage investment conduit (REMIC), a financial asset securitization investment trust (FASIT), or a real estate investment trust (REIT). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code is computed.

WE EXPRESS NO OPINION concerning the effect on excludability of interest of subsequent action which under the terms of the Ordinance may be taken only upon receipt of an opinion of counsel of nationally recognized standing in the field of municipal bond law.

WE EXPRESS NO OTHER OPINION with respect to any other federal, state, or local tax consequences under present law or any proposed legislation resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Notes. Ownership of tax-exempt obligations such as the Notes may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain S corporations with subchapter C earnings and profits, certain foreign corporations doing business in the United States, owners of an interest in a FASIT, individuals otherwise qualifying for the earned income tax credit, individual recipients of Social Security or Railroad Retirement benefits, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

OUR OPINIONS ARE BASED on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

APPENDIX B



CPS ENERGY

BANK OVERVIEW

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BANK OVERVIEW

State Street Bank and Trust Company

State Street Bank and Trust Company (the "Bank") is a wholly-owned subsidiary of State Street Corporation (the "Corporation"). The Corporation (NYSE: STT) is a leading specialist in providing institutional investors with investment servicing, investment management and investment research and trading. With \$11.9 trillion in assets under custody and \$1.7 trillion in assets under management, the Corporation operates in 26 countries and more than 100 markets worldwide. The assets of the Bank at December 31, 2006 accounted for approximately 90% of the consolidated assets of the Corporation. At December 31, 2006, the Corporation had total assets of \$107.4 billion, total deposits (including deposits in foreign offices) of \$65.6 billion, total loans and lease finance assets net of unearned income, allowance and reserve for possible credit losses of approximately \$8.9 billion and total equity capital of \$7.3 billion.

The Bank's Consolidated Reports of Condition for Insured Commercial and State Chartered Savings Banks FFIEC 031 for December 31, 2006, as submitted to the Federal Reserve Bank of Boston, are incorporated by reference in this Appendix and shall be deemed to be a part hereof.

In addition, all reports filed by the Bank pursuant to 12 U.S.C. §324 after the date of the Offering Memorandum shall be deemed to be incorporated herein by reference and shall be deemed to be a part hereof from the date of filing of any such report.

Additional information, including financial information relating to the Corporation and the Bank is set forth in the Corporation's Annual Report or Form 10-K for the year ended December 31, 2006. The annual report can be found on the Corporation's web site, www.statestreet.com. Such report and all reports filed by the Corporation pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, after the date of the Offering Memorandum are incorporated herein by reference and shall be deemed a part hereof from the date of filing of any such report. The Revolving Credit Agreement is an obligation of the Bank and not of the Corporation.

Any statement contained in any document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of the Offering Memorandum to the extent that a statement contained herein or in any subsequently filed document that also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of the Offering Memorandum.

The Bank hereby undertakes to provide, without charge to each person to whom a copy of the Offering Memorandum has been delivered, on the written request of any such person, a copy of any or all of the documents referred to above which have been or may be incorporated in the Offering Memorandum by reference, other than exhibits to such documents. Written requests for such copies should be directed to Investor Relations, State Street Corporation, One Lincoln Street, Boston, Massachusetts 02111, telephone number (617) 786-3000.

Neither the Bank nor its affiliates make any representation as to the contents of the Offering Memorandum (except as to this Appendix to the extent it relates to the Bank), the suitability of the Notes for any investor, the feasibility or performance of any project or compliance with any securities or tax laws or regulations.

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Bank of America, N.A.

Bank of America, N.A. (the "*Bank*") is a national banking association organized under the laws of the United States, with its principal executive offices located in Charlotte, North Carolina. The Bank is a wholly-owned indirect subsidiary of Bank of America Corporation (the "*Corporation*") and is engaged in a general consumer banking, commercial banking and trust business, offering a wide range of commercial, corporate, international, financial market, retail and fiduciary banking services. As of March 31, 2007, the Bank had consolidated assets of \$1,204 billion, consolidated deposits of \$761 billion and stockholder's equity of \$109 billion based on regulatory accounting principles.

The Corporation is a bank holding company and a financial holding company, with its principal executive offices located in Charlotte, North Carolina. Additional information regarding the Corporation is set forth in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, together with any subsequent documents it filed with the Securities and Exchange Commission (the "*SEC*") pursuant to the Securities Exchange Act of 1934, as amended (the "*Exchange Act*").

Recent Developments: In April 2007, the Corporation announced an agreement to purchase ABN AMRO North America Holding Company, parent company of LaSalle Bank Corporation, from ABN AMRO Bank N.V (collectively, ABN AMRO) for \$21 billion in cash. The transaction has been approved by both company's boards of directors. On May 3, 2007, a court in the Netherlands ruled that ABN AMRO is enjoined from consummating the transaction until ABN AMRO's public shareholders vote on the proposed transaction. The Corporation has filed a lawsuit against ABN AMRO in a federal district court located in New York to enforce its legal rights.

Additional information regarding the foregoing is available from the filings made by the Corporation with the SEC, which filings can be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549, United States, at prescribed rates. In addition, the SEC maintains a website at <http://www.sec.gov>, which contains reports, proxy statements and other information regarding registrants that file such information electronically with the SEC.

The information concerning the Corporation, the Bank and the foregoing mergers contained herein is furnished solely to provide limited introductory information and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the documents and financial statements referenced herein.

Moody's Investors Service, Inc. ("*Moody's*") currently rates the Bank's long-term debt as "Aaa" and short-term debt as "P-1." The outlook is stable. Standard & Poor's rates the Bank's long-term debt as "AA+" and its short-term debt as "A-1+." The outlook is stable. Fitch Ratings, Inc. ("*Fitch*") rates long-term debt of the Bank as "AA" and short-term debt as "F1+." The outlook is stable. Further information with respect to such ratings may be obtained from Moody's, Standard & Poor's and Fitch, respectively. No assurances can be given that the current ratings of the Bank's instruments will be maintained.

The Bank will provide copies of the most recent Bank of America Corporation Annual Report on Form 10-K, any subsequent reports on Form 10-Q, and any required reports on Form 8-K (in each case as filed with the Commission pursuant to the Exchange Act), and the publicly available portions of the most recent quarterly Call Report of the Bank delivered to the Comptroller of the Currency, without charge, to each person to whom this document is delivered, on the written request of such person. Written requests should be directed to:

Bank of America Corporate Communications
100 North Tryon Street, 18th Floor
Charlotte, North Carolina 28255
Attention: Corporate Communications

PAYMENTS OF PRINCIPAL AND INTEREST ON THE NOTES MAY BE MADE FROM DRAWINGS UNDER AND IN ACCORDANCE WITH THE REVOLVING CREDIT AGREEMENT. ALTHOUGH THE REVOLVING CREDIT AGREEMENT IS A BINDING OBLIGATION OF THE BANK, THE NOTES ARE NOT DEPOSITS OR OBLIGATIONS OF THE CORPORATION OR ANY OF ITS AFFILIATED BANKS AND ARE NOT GUARANTEED BY ANY OF THESE ENTITIES. THE NOTES ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE

CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY AND ARE SUBJECT TO CERTAIN INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF THE PRINCIPAL AMOUNT INVESTED.

The delivery hereof shall not create any implication that there has been no change in the affairs of the Corporation or the Bank since the date hereof, or that the information contained or referred to in this Appendix is correct as of any time subsequent to its date.

APPENDIX C



CPS ENERGY

**AUDITED FINANCIAL STATEMENTS
FOR THE FISCAL YEARS ENDED
JANUARY 31, 2007 AND 2006
AND INDEPENDENT AUDITORS' REPORT**

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MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") serves as an introduction to the financial statements of City Public Service of San Antonio (also referred to as "CPS Energy," "CPS" or the "Company"). It is intended to be an objective and easily understandable analysis of significant financial and operating activities and events for the fiscal year ended January 31, 2007 ("FY 2007"), compared to the fiscal year ended January 31, 2006 ("FY 2006"). It also provides an overview of CPS Energy's general financial condition and results of operations FY 2006 compared to the previous fiscal year ended January 31, 2005 ("FY 2005"). This MD&A has been prepared in accordance with the Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and should be read in conjunction with the financial statements and accompanying notes that follow.

BASIC FINANCIAL STATEMENTS

The Balance Sheets present CPS Energy's assets, liabilities and fund net assets as of the end of each fiscal year. Assets are separated into current and noncurrent categories and are reported in the order of liquidity. Current assets include unrestricted cash and cash equivalents, investments, receivables and inventories, as well as prepayments and other current assets. Noncurrent assets include cash and cash equivalents; investments; and interest receivables that have been restricted by state laws, ordinances or contracts. Noncurrent assets also include prepayments, deferred costs and net capital assets.

Liabilities are also segregated into current and noncurrent categories. Current liabilities include the current maturities of revenue bonds, as well as accounts payable and accrued liabilities. Noncurrent liabilities include net long-term debt, the South Texas Project ("STP") decommissioning trusts' liabilities, deferred revenue and other noncurrent liabilities.

The Balance Sheets report fund net assets as the difference between total assets and total liabilities. The fund net assets are classified as invested in net capital assets, restricted or unrestricted. An unrestricted designation indicates the funds are available for operations.

Within the Statements of Revenues, Expenses and Changes in Fund Net Assets, operating results are reported separately from nonoperating activities, which primarily relate to financing and investing. Contributed capital is also reported separately as a component of the change in fund net assets. These statements identify revenue generated from sales to cover operating expenses. Operating expenses are presented by major cost categories. Revenues remaining are available for debt service, to fulfill city payment commitments, finance capital expenditures and cover contingencies.

The Statements of Cash Flows present operating activities, capital and related financing activities, noncapital financing activities, and investing activities. These statements are prepared using the direct method, which reports cash receipts, along with payments, and presents a reconciliation of operating income to net cash provided by operating activities.

FINANCIAL HIGHLIGHTS AND SIGNIFICANT ACCOUNTING POLICIES

Contributed Capital – Contributions made for construction of capital assets flow through the Statements of Revenues, Expenses and Changes in Fund Net Assets and are shown on the Balance Sheets as part of equity that is invested in capital and other assets. The amount reported for contributed capital was \$22.9 million for FY 2007, as compared with \$63.4 million for FY 2006. The portion of these balances that represents contributions received from customers as payments for utility extensions and services was \$22.4 million for FY 2007 and \$16.4 million for FY 2006. FY 2006 also included contributions received under an agreement with Texas Genco, II L.P. ("Texas Genco") that terminated on January 24, 2006. For additional information regarding this agreement, see the section entitled "Operational Changes."

CPS Energy Component Units – Fund net assets at January 31, 2007, totaled \$3.1 billion, as compared with \$3.0 billion at January 31, 2006. Under GASB Statement No. 14, *The Financial Reporting Entity*, these amounts include the assets and liabilities accumulated for the following:

- City Public Service of San Antonio Disability Income, Group Life Insurance and Group Health Plans ("Employee Benefit Plans") and
- CPS Energy's two decommissioning trusts for STP ("Decommissioning Trusts").

In compliance with the provisions of GASB Statement No. 14, the Employee Benefit Plans and the Decommissioning Trusts (severally and collectively referred to as "component units") are included in CPS Energy's financial statements using the blended method of inclusion, which combines the activity of the component units.

Initially, CPS Energy owned a 28% interest in STP. In May 2005, CPS Energy purchased an additional 12% interest in STP. Assets from an associated decommissioning trust were also received with this purchase. CPS Energy reports the assets in both trusts—the new 12% interest and the original 28% interest—as component units. There were no fund net assets associated with the Decommissioning Trusts for either year since the decommissioning liabilities equaled the assets.

For the Employee Benefit Plans at January 31, 2007, and January 31, 2006, the restricted fund net assets were \$203.1 million and \$178.0 million, respectively. These fund net assets were comprised of cash and cash equivalents, investments and interest receivable, less payables for the Employee Benefit Plans.

STP – Correlating to CPS Energy's 40% interest in STP, the applicable financial results of this nonprofit special-purpose project were fully combined within these financial statements.

Pension Plan – According to the GASB Staff Implementation Guide for GASB Statement No. 14, if an entity is acting in a trustee capacity with regard to its pension plan, the assets of the pension plan should not be evaluated as a potential component unit, but should be reported separately. CPS Energy, through its Oversight Committee and Administrative Committee, acts in a trustee capacity for the Pension Plan. Therefore, consistent with the GASB Statement No. 14 Implementation Guide, the Pension Plan has not been categorized as a component unit of CPS Energy. Accordingly, the financial statements of the Pension Plan are separately audited and reported, and those financial results are not included herein except for certain disclosures provided in Note 8 – Employee Pension Plan.

Securities Lending – CPS Energy, the 28% Decommissioning Trust and the 12% Decommissioning Trust began engaging in securities lending transactions in FY 2007 under a contract with their lending agent, Frost National Bank. GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending

transactions. This guidance includes reporting certain securities lending collateral on the Balance Sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

The City of San Antonio – CPS Energy is a municipal utility owned by the City of San Antonio, Texas ("City"). In turn, CPS Energy is treated as a component unit of the City, which has a financial year that ends September 30.

Summary of Revenues, Expenses and Changes in Fund Net Assets

(In thousands)

	Fiscal Year Ended January 31,			Change			
	2007	2006	2005	2007 vs. 2006		2006 vs. 2005	
Revenues and nonoperating income							
Electric	\$ 1,515,746	\$ 1,437,798	\$ 1,220,874	\$ 77,948	5.4%	\$ 216,924	17.8%
Gas	254,340	244,921	201,531	9,419	3.8%	43,390	21.5%
Total operating revenues	1,770,086	1,682,719	1,422,405	87,367	5.2%	260,314	18.3%
Nonoperating income, net	121,694	57,219	47,547	64,475	112.7%	9,672	20.3%
Total revenues and nonoperating income	1,891,780	1,739,938	1,469,952	151,842	8.7%	269,986	18.4%
Expenses							
Operating expenses							
Fuel, purchased power and distribution gas	659,839	638,636	492,198	21,203	3.3%	146,438	29.8%
STP operation and maintenance	115,269	101,735	72,164	13,534	13.3%	29,571	41.0%
Other operation and maintenance	260,569	242,963	243,089	17,606	7.2%	(126)	-0.1%
Employee benefit plans	25,513	27,820	23,673	(2,307)	-8.3%	4,147	17.5%
Regulatory assessments	28,645	37,083	42,076	(8,438)	-22.8%	(4,993)	-11.9%
Decommissioning	32,721	10,207	13,365	22,514	220.6%	(3,158)	-23.6%
Depreciation and depletion	262,375	246,410	236,686	15,965	6.5%	9,724	4.1%
Total operating expenses	1,384,931	1,304,854	1,123,251	80,077	6.1%	181,603	16.2%
Nonoperating expenses							
Interest and debt-related	156,862	153,573	143,241	3,289	2.1%	10,332	7.2%
Payments to the City of San Antonio	235,898	227,178	194,901	8,720	3.8%	32,277	16.6%
Total nonoperating expenses	392,760	380,751	338,142	12,009	3.2%	42,609	12.6%
Total expenses	1,777,691	1,685,605	1,461,393	92,086	5.5%	224,212	15.3%
Income before other changes in fund net assets	114,089	54,333	8,559	59,756	110.0%	45,774	534.8%
Other transfers to the City of San Antonio	(9,594)	(8,639)	-	(955)	11.1%	(8,639)	-
Contributed capital	22,857	63,421	47,666	(40,564)	-64.0%	15,755	33.1%
Adjustment for STP pension cost	1,505	(177)	-	1,682	-950.3%	(177)	-
Change in fund net assets	128,857	108,938	56,225	19,919	18.3%	52,713	93.8%
Fund net assets – beginning	2,994,539	2,885,601	2,829,376	108,938	3.8%	56,225	2.0%
Fund net assets – ending	\$ 3,123,396	\$ 2,994,539	\$ 2,885,601	\$ 128,857	4.3%	\$ 108,938	3.8%

RESULTS OF OPERATIONS

Total Revenues and Nonoperating Income

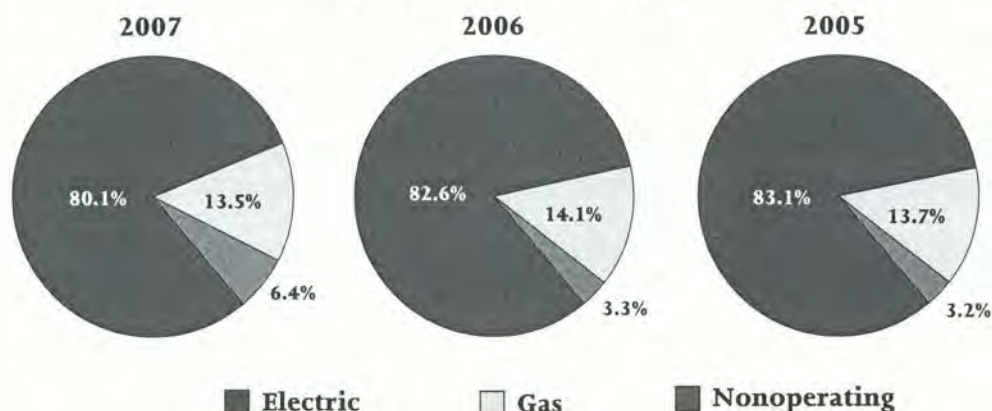
FY 2007 – Representing 93.6% of total revenues and nonoperating income, electric and gas revenues of \$1.8 billion increased by \$87.4 million, or 5.2%, compared to FY 2006. Additionally, CPS Energy had \$121.7 million in net nonoperating income for FY 2007 compared to \$57.2 million for FY 2006.

Electric energy is generated from several fuel sources—coal, nuclear and gas, with some purchased energy, including wind. Comprising 80.1% of CPS Energy's total revenues and nonoperating income, electric revenue of \$1.5 billion increased 5.4% from FY 2006. This was due primarily to increases of \$49.2 million in system nonfuel recoveries, \$24.5 million in off-system nonfuel recoveries, and \$15.7 million in off-system fuel recoveries. These increases were partially offset by a decrease of

\$11.9 million in regulatory recoveries. Nonfuel electric recoveries rose due to a 10.2% increase in electric sales as a result of higher usage per customer due to warmer summer weather, as well as customer growth. The number of electric customers increased 23,130, from 639,001 at January 31, 2006, to 662,131 at January 31, 2007.

Total Revenues and Nonoperating Income

Fiscal Year Ended January 31,



Representing 13.5% of total revenues and nonoperating income, gas revenue for FY 2007, totaled \$254.3 million, a 3.8% increase from FY 2006. The increase was due primarily to a gas rate adjustment that became effective June 26, 2006, as well as an increase in sales and related nonfuel recoveries. Gas sales totaled 22.4 million MCF for FY 2007, compared to 21.1 million MCF for FY 2006, as colder winter weather increased customer usage. Gas fuel recoveries also rose due to the higher sales, while the unit cost for gas decreased 4.1%. Additionally, the gas customer base increased by 3,925 to 314,785.

Net nonoperating income of \$121.7 million increased \$64.5 million from FY 2006. This increase was mostly due to higher interest income resulting from a greater level of invested funds and higher yields. Total nonoperating income for FY 2007 was reported net of expenses of \$2.1 million that were incurred to support property rental and other miscellaneous services.

FY 2006 – Representing 96.7% of total revenues and nonoperating income, electric and gas revenues of \$1.7 billion increased by \$260.3 million, or 18.3%, compared to FY 2005. Additionally, CPS Energy had \$57.2 million in net nonoperating income for FY 2006 compared to \$47.5 million the previous fiscal year.

Representing 82.6% of CPS Energy's total revenues and nonoperating income, electric revenue of \$1.4 billion increased 17.8% from FY 2005. This was due primarily to increases of \$111.2 million in system fuel recoveries, \$80.9 million in system nonfuel recoveries, and \$37.2 million in off-system fuel and nonfuel recoveries. A rise in gas costs was a significant factor in higher fuel recovery revenue. In addition, overall electric sales increased 6.6% as a result of higher usage per customer due to hotter weather and customer growth. The number of electric customers increased 21,003, from 617,998 at January 31, 2005, to 639,001 at January 31, 2006.

Representing 14.1% of total revenues and nonoperating income, gas revenue for FY 2006 totaled \$244.9 million, a 21.5% increase from FY 2005. The increase was due primarily to fuel cost recoveries as a result of a 33.8% increase in the unit price. Gas sales totaled 21.1 million MCF compared to

22.4 million MCF for FY 2005. Gas customers at January 31, 2006, totaled 310,860, an increase of 2,304 from the prior fiscal year.

Net nonoperating income of \$57.2 million increased \$9.7 million from FY 2005. This increase was mostly due to higher interest income resulting from a greater level of invested funds and higher yields. Total nonoperating income for FY 2006 was reported net of expenses of \$1.7 million that were incurred to support property rental and other miscellaneous services.

Operating Expenses

FY 2007 – Operating expenses totaled \$1.4 billion and were \$80.1 million, or 6.1%, higher than FY 2006.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$659.8 million increased by \$21.2 million. Electric fuel and purchased power increased by \$17.3 million to \$485.0 million, as generation requirements were 10.7% higher due to greater usage per customer and a larger customer base. Relative to distribution gas, costs increased \$3.9 million to \$174.8 million as gas purchases increased 6.7% based on greater usage per customer and more gas customers.

STP operation and maintenance expenses for FY 2007 were \$115.3 million, or \$13.6 million higher than FY 2006, as CPS Energy increased its ownership in STP in May 2005 by acquiring an additional 12%, thus increasing its share of costs and reflecting a full year of ownership.

Other operation and maintenance expenses for FY 2007 were \$260.6 million, or \$17.6 million higher than FY 2006 due to higher costs necessary to serve the greater customer base.

The costs of the Employee Benefit Plans for FY 2007 decreased \$2.3 million from FY 2006 to \$25.5 million due to higher employee contributions.

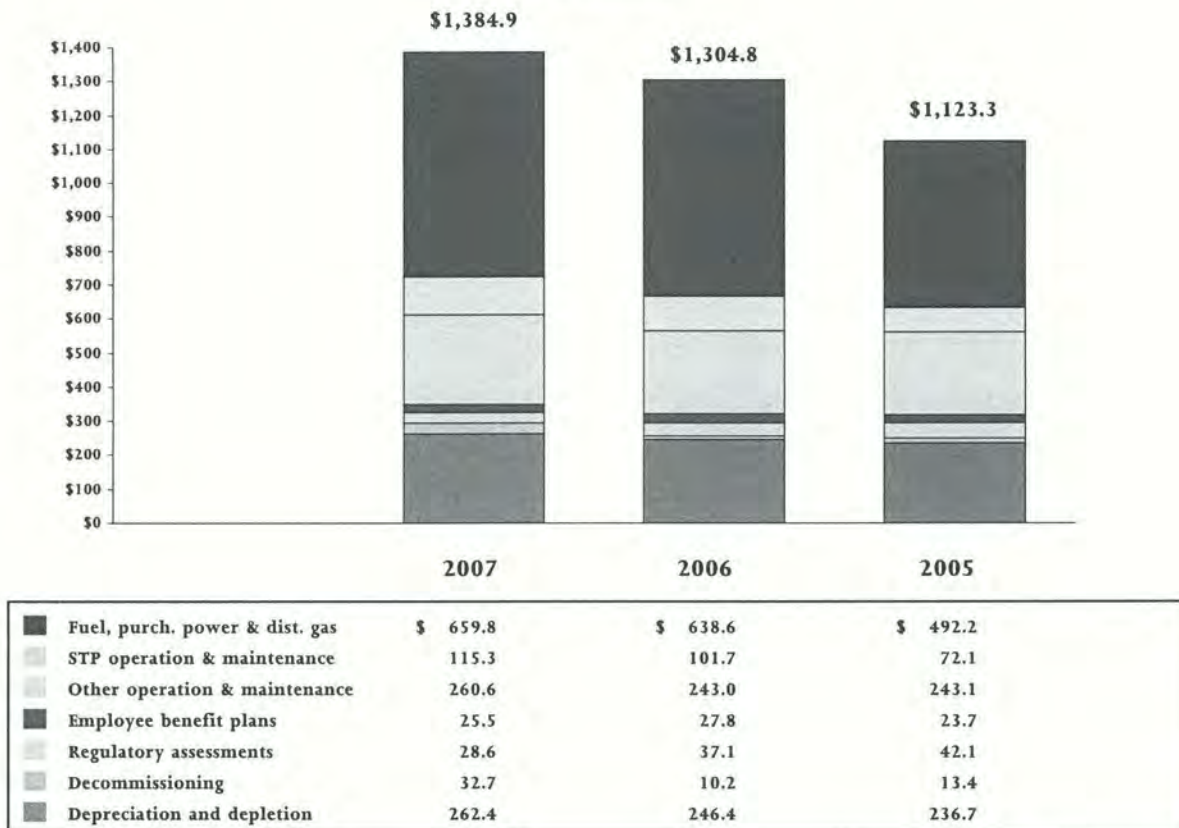
Regulatory assessments were \$28.6 million for FY 2007, a decrease of \$8.5 million, or 22.8%, compared to FY 2006. Electric Reliability Council of Texas ("ERCOT") related costs decreased \$14.8 million, including decreases for Reserve Service fees and Out of Merit Replacement Capacity and Energy charges, along with higher credits for Reserve Uplift charges and Transmission Congestion Rights Auction Credits. Partially offsetting the ERCOT decreases was an increase of \$6.3 million in the Public Utility Commission of Texas ("PUCT") Transmission Costs of Service ("TCOS") payments.

In January 2007, the PUCT approved CPS Energy's application to change its rates for wholesale transmission service. Due to an increase in capital projects, CPS Energy's newly approved transmission revenue requirements of \$94.9 million, which were based on FY 2006 data, are significantly higher than the previously approved transmission revenue requirements of \$59.8 million, which were based on the data from the fiscal year ended January 31, 2003.

Decommissioning expenses totaled \$32.7 million in FY 2007 and were \$22.5 million higher than FY 2006. Due to the zero fund net assets of the decommissioning trusts, the increase in decommissioning expenses are directly related to the increases in investment income of the two trusts.

Depreciation and depletion expense of \$262.4 million for FY 2007 was \$16.0 million higher than FY 2006. This primarily reflected capital additions, which included a full year of the 12% STP ownership purchase, various substation and transmission line projects, and a baghouse installation.

Total Operating Expenses
Fiscal Year Ended January 31,
(In millions)



FY 2006 – Operating expenses totaled \$1.3 billion. These expenses were \$181.5 million, or 16.2%, higher than FY 2005.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$638.6 million increased by \$146.4 million, or 29.8%. Electric fuel and purchased power increased by \$109.5 million to \$467.7 million, reflecting higher electric generation requirements caused by hotter weather as indicated by a 16.1% increase in cooling-degree days. In addition, the average unit price per MWh was 23.1% higher than FY 2005 primarily due to increases in the price of gas and a higher level of gas-fueled electric generation. Relative to distribution gas, costs increased \$36.9 million to \$170.9 million, as the average unit cost increased 33.8%. Partially offsetting the unit cost increase was a 4.6% decrease in the volume of distribution gas purchases, as usage per customer decreased 6.0%, which related to a corresponding decrease in heating-degree days.

STP operation and maintenance expenses for FY 2006 were \$101.7 million, or \$29.6 million higher than FY 2005, as CPS Energy increased its ownership in this nuclear operating company in May 2005 by acquiring an additional 12%, thus increasing its share of costs. Additionally, there were two planned maintenance outages this year compared to one in the prior fiscal year.

Other operation and maintenance expenses were comparable to the prior year.

The costs of the Employee Benefit Plans for FY 2006 were \$27.8 million, which increased \$4.1 million, or 17.5%, from FY 2005. The increase was due to a higher level of health claims.

Regulatory assessments were \$37.1 million for FY 2006, a decrease of \$5.0 million, or 11.9%, compared to FY 2005. The PUCT TCOS payments were \$3.0 million lower principally due to a two-year refund amount from the Lower Colorado River Authority reported in FY 2006, as well as CPS Energy's TCOS rate adjustment in May 2004 that favorably affected all of FY 2006, but only nine months of FY 2005. Additionally, ERCOT-related costs decreased \$2.0 million, as Transmission Congestion Rights Auction Credits increased while Reserve Must Run Service Fees decreased.

Decommissioning expense totaled \$10.2 million for FY 2006 and was \$3.2 million lower than FY 2005. The decrease in decommissioning expense was primarily due to a lower funding requirement as called for by the decommissioning cost study conducted in June 2004.

Depreciation and depletion expense of \$246.4 million for FY 2006 was \$9.7 million, or 4.1%, higher than FY 2005. This primarily reflected new plant additions, which included the 12% ownership purchase of STP and a new Energy Management Center added late in FY 2005.

Nonoperating Expenses

FY 2007 – Interest and debt-related costs of \$156.9 million were \$3.3 million higher than FY 2006. This was due to additional interest costs on the Senior Lien and commercial paper borrowings completed in August 2006, as well as higher costs on Junior Lien debt that has a variable rate that rose as a result of changes in the market. Also, \$7.2 million in costs for the cash defeasance of debt were incurred in FY 2007. These amounts were partially offset by a higher allowance for funds used during construction ("AFUDC") for projects such as the new J.K. Spruce Unit 2 ("Spruce 2") coal generating plant currently under construction and lower debt amortization costs.

CPS Energy is a wholly owned component unit of the City. In accordance with the Company's bond ordinances, no more than 14% of CPS Energy's gross system revenues can be remitted to the City each year. Payments to the City for FY 2007 totaled \$235.9 million and were 3.8% higher than FY 2006. This reflected the increase in gross revenues subject to City payment, including higher fuel and nonfuel recoveries, and greater nonoperating revenues.

In addition to the City payments noted above, CPS Energy recorded \$9.6 million in other transfers to the City. These additional distributions are separately reported with other changes in fund net assets. After these additional distributions, CPS Energy was still in accordance with its bond ordinances. Distributions to the City were under 14% of the company's gross system revenues.

FY 2006 – Interest and debt-related costs of \$153.6 million were \$10.3 million higher than FY 2005. The interest on the Junior Lien, Variable Rate Demand Obligation ("VRDO") bonds increased as a result of a \$160.0 million bond issue in November 2004 and an increase in market rates over FY 2005. The issuance of \$240.7 million in long-term debt in April 2005, along with the issuance of \$197.3 million in October of that year, caused the interest on Senior Lien debt to increase \$4.4 million. Higher rates caused commercial paper interest to also increase. These increases were partially offset by lower debt-related amortization and a higher level of AFUDC, also known as capitalized interest.

Payments to the City for FY 2006 totaled \$227.2 million and were 16.6% higher than FY 2005. This reflected the increase in gross revenue subject to City payment, including higher electric fuel and nonfuel recoveries, greater nonoperating revenues and increased gas fuel recoveries.

In addition to the City payments noted above, CPS Energy recorded \$8.6 million in other transfers to the City. These additional distributions are separately reported after income from operations. After

these additional distributions, CPS Energy was still in accordance with its bond ordinances. Distributions to the City were under 14% of the company's gross system revenues.

Other Changes In Fund Net Assets

FY 2007 – Income before other changes in fund net assets totaled \$114.1 million for FY 2007, an increase of \$59.8 million from FY 2006. Contributed capital of \$22.9 million was \$40.5 million lower than FY 2006 due to the termination of the Joint Operations Agreement ("JOA") in January 2006. For additional information, see section titled "Operational Changes." After recording \$22.9 million in contributed capital, \$9.6 million of additional transfers to the City, and a \$1.5 million STP pension adjustment, CPS Energy's change in fund net assets was \$128.9 million, which was \$20.0 million above last year.

FY 2006 – Income before other changes in fund net assets totaled \$54.3 million for FY 2006, an increase of \$45.8 million from FY 2005. After recording \$63.4 million in contributed capital, \$8.6 million of additional transfers to the City, and an adjustment for STP pension cost of (\$0.2) million, the overall change in fund net assets for the period totaled \$108.9 million compared to \$56.2 million for FY 2005.

FINANCIAL POSITION

Balance Sheets Summary

(In thousands)

	January 31,			Change			
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005		
Assets							
Current assets	\$ 1,294,575	\$ 600,305	\$ 619,597	\$ 694,270	115.7%	\$ (19,292)	-3.1%
Noncurrent assets							
Noncurrent assets - restricted	1,541,002	1,265,556	1,123,716	275,446	21.8%	141,840	12.6%
Other noncurrent assets	514,017	524,408	543,183	(10,391)	-2.0%	(18,775)	-3.5%
Capital assets, net	5,294,792	4,942,636	4,645,994	352,156	7.1%	296,642	6.4%
Total assets	\$ 8,644,386	\$ 7,332,905	\$ 6,932,490	\$ 1,311,481	17.9%	\$ 400,415	5.8%
Liabilities							
Current liabilities	\$ 1,082,821	\$ 391,331	\$ 311,493	\$ 691,490	176.7%	\$ 79,838	25.6%
Long-term debt, net	3,327,551	2,963,596	2,838,892	363,955	12.3%	124,704	4.4%
Other noncurrent liabilities	1,110,618	983,439	896,504	127,179	12.9%	86,935	9.7%
Total liabilities	\$ 5,520,990	\$ 4,338,366	\$ 4,046,889	\$ 1,182,624	27.3%	\$ 291,477	7.2%
Fund net assets							
Invested in capital assets, net of related debt	\$ 2,118,261	\$ 1,949,167	\$ 1,821,531	\$ 169,094	8.7%	\$ 127,636	7.0%
Restricted	792,920	847,572	750,495	(54,652)	-6.4%	97,077	12.9%
Unrestricted	212,215	197,800	313,575	14,415	7.3%	(115,775)	-36.9%
Fund net assets	\$ 3,123,396	\$ 2,994,539	\$ 2,885,601	\$ 128,857	4.3%	\$ 108,938	3.8%

Current Assets

FY 2007 – The increase in current assets of \$694.3 million, from \$600.3 million as of January 31, 2006, to \$1.3 billion as of January 31, 2007, was primarily due to \$626.4 million received in securities lending collateral, a \$66.9 million general funds increase due primarily to greater level of invested funds, and a \$34.2 million increase in customer accounts receivable resulting from greater electric and gas customers usage driven by the weather. These increases were partially offset by various decreases, which primarily included a reduction of \$27.0 million in gas inventories resulting from a decrease in gas storage levels and \$15.5 million in lower miscellaneous receivables due mostly to the termination of the JOA.

FY 2006 – The decline in current assets of \$19.3 million, from \$619.6 million as of January 31, 2005, to \$600.3 million as of January 31, 2006, was due to \$75.7 million in general funds used for construction, partially offset by various increases. These increases primarily included a rise in fuel inventories of \$32.0 million principally due to higher fuel commodity prices and CPS Energy's increased interest in STP, an increase in the JOA receivable of \$5.7 million, an increase of \$1.8 million related to hurricane assistance billings, a rise in the prepaid margin fuel account of \$5.5 million for future option calls, and \$15.7 million in additional fuel hedges.

Noncurrent Assets – Restricted

FY 2007 – The increase in noncurrent assets - restricted of \$275.4 million, from \$1.3 billion as of January 31, 2006, to \$1.5 billion as of January 31, 2007, was primarily due to a net increase of \$183.7 million from new bond issue and commercial paper proceeds for capital projects and a \$171.2 million increase in the component units restricted assets, including \$110.0 million received in securities lending collateral for the STP Decommissioning Trust. These increases were partially offset by a decrease of \$83.2 million in the Repair and Replacement Account from funding of capital projects.

FY 2006 – The increase in noncurrent assets - restricted of \$141.8 million, from \$1.1 billion as of January 31, 2005, to \$1.3 billion as of January 31, 2006, was partially due to a net increase of \$86.6 million in the Repair and Replacement Account from additional funding from operations and an \$83.9 million increase in the component units restricted assets, which was primarily due to the purchase of 12% additional ownership in STP. These increases were partially offset by a decrease of \$34.1 million in the Bond Construction Fund from funding of capital projects.

Other Noncurrent Assets

FY 2007 – Other noncurrent assets declined from \$524.4 million as of January 31, 2006, to \$514.0 million as of January 31, 2007. The \$10.4 million decrease related primarily to a June 2000 lease/leaseback transaction for CPS Energy's J.K. Spruce Unit 1 ("Spruce 1") property, whereby \$637.0 million in prepaid rent is being amortized over approximately 32 years. Partially offsetting the \$19.8 million decrease related to the lease/leaseback amortization is a \$6.4 million increase in various long-term receivables and a \$3.0 million increase in STP additional minimum pension liability.

FY 2006 – The decline in other noncurrent assets of \$18.8 million, from \$543.2 million as of January 31, 2005, to \$524.4 million as of January 31, 2006, was related primarily to a June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$637.0 million in prepaid rent is being amortized over approximately 32 years.

Capital Assets, Net

FY 2007 – At January 31, 2007, net capital assets of \$5.3 billion included an increase of \$352.2 million from the amount recorded at the end of FY 2006. Total additions to plant-in-service of \$476.0 million and an increase in construction-in-progress of \$122.8 million, the most significant contributors to this increase, were offset by depreciation and depletion of \$262.4 million. In addition, capitalized nuclear fuel increased by \$10.5 million due to higher purchases than the amount amortized.

Construction on Spruce 2 started on March 21, 2006, with plans for commercial operation in 2010. CPS Energy selected Calaveras Power Partners—a team led by Zachry Construction Corporation of San Antonio—to construct the 750-megawatt coal-fired generating unit at Calaveras Lake. Spruce 2 will be the largest of the four coal units at Calaveras Lake and will be equipped with current emissions-control technology.

Increases in construction-in-progress included expenditures for Spruce 2, J.T. Deely Units 1 and 2 Baghouses, and a new transmission line between CPS Energy's Cagnon substation to the Kendall and Bexar County property line (also referred to as the Cagnon-to-Kendall transmission line). During FY 2007, the J.T. Deely Unit 2 Baghouse and the Cagnon-to-Kendall transmission line were completed and moved into plant-in-service.

Of the total plant-in-service and construction-in-progress additions, \$607.8 million related to new construction and removal costs. These additions were funded from \$246.6 million of tax-exempt bonds, \$173.3 million of tax-exempt commercial paper, \$1.7 million from the Overhead Conversion Fund, \$31.6 million from Contributed Capital, and \$154.6 million from the Repair and Replacement Account.

Net capital assets included reserves for dismantling costs. These reserves are reflected in the credits shown in the Summary of Capital Assets, Net of Accumulated Depreciation table under the categories "Electric plant – Machinery and equipment" and "General plant – Other."

Summary of Capital Assets, Net of Accumulated Depreciation (In thousands)

	January 31,			Change			
	2007	2006	2005	2007 vs. 2006		2006 vs. 2005	
Nondepreciable assets							
Land	\$ 60,080	\$ 58,651	\$ 56,482	\$ 1,429	2.4%	\$ 2,169	3.8%
Nonutility land	12,599	12,599	12,599	-	0.0%	-	0.0%
Construction-in-progress	419,795	296,946	180,594	122,849	41.4%	116,352	64.4%
Total nondepreciable assets	492,474	368,196	249,675	124,278	33.8%	118,521	47.5%
Nuclear fuel	69,976	59,470	35,389	10,506	17.7%	24,081	68.0%
Utility property leased	17,945	18,449	18,449	(504)	-2.7%	-	0.0%
Electric plant							
Buildings and structures	621,558	649,345	625,229	(27,787)	-4.3%	24,116	3.9%
Systems and improvements	3,275,924	3,083,259	3,007,179	192,665	6.2%	76,080	2.5%
Machinery and equipment	(6,506)	(4,054)	(4,297)	(2,452)	60.5%	243	5.7%
Total electric plant	3,890,976	3,728,550	3,628,111	162,426	4.4%	100,439	2.8%
Gas plant							
Buildings and structures	27	27	30	-	0.0%	(3)	-10.0%
Systems and improvements	396,350	383,066	325,071	13,284	3.5%	57,995	17.8%
Total gas plant	396,377	383,093	325,101	13,284	3.5%	57,992	17.8%
General plant							
Buildings and structures	120,978	117,233	120,812	3,745	3.2%	(3,579)	-3.0%
Machinery and equipment	315,657	276,804	277,866	38,853	14.0%	(1,062)	-0.4%
Other	(9,591)	(9,159)	(9,409)	(432)	4.7%	250	2.7%
Total general plant	427,044	384,878	389,269	42,166	11.0%	(4,391)	-1.1%
Total capital assets, net	\$ 5,294,792	\$ 4,942,636	\$ 4,645,994	\$ 352,156	7.1%	\$ 296,642	6.4%

FY 2006 – At January 31, 2006, net capital assets of \$4.9 billion included an increase of \$296.6 million from the amount recorded at the end of FY 2005. Total additions to plant-in-service of \$396.8 million and an increase in construction-in-progress of \$116.4 million were offset by depreciation of \$246.4 million.

The increase in plant-in-service included funding the acquisition of the additional 12% share in STP. Funding was achieved with bond proceeds. Net capital assets also included reserves for dismantling costs. These reserves are reflected in the credits shown in the Summary of Capital Assets, Net of

Accumulated Depreciation table under the categories "Electric plant – Machinery and equipment" and "General plant – Other." Increases in construction-in-progress included expenditures toward the new coal-fired plant, Spruce 2; J.T. Deely Units 1 and 2 Baghouses; and the new Cagnon-to-Kendall transmission line.

Of the total plant-in-service and construction-in-progress additions, \$522.1 million related to new construction and removal costs. These additions were funded from \$276.2 million of tax-exempt bonds, \$75.7 million from general funds, \$1.9 million from the Overhead Conversion Fund, \$51.1 million from Contributed Capital, and \$117.2 million from the Repair and Replacement Account.

Current Liabilities (Excluding Debt)

FY 2007 – Excluding current maturities on long-term debt, current liabilities increased \$684.9 million, from \$256.2 million as of January 31, 2006, to \$941.1 million as of January 31, 2007. The increase was primarily due to \$626.4 million in securities lending obligation, a \$48.7 million increase in amounts for vendor payables due partly to major construction projects, i.e., Spruce 2, and a \$9.5 million increase in natural gas purchase payables. Partially offsetting the increases were reduced Employee Incentive Plan accruals of \$7.5 million and \$4.3 million lower STP operations, maintenance and construction payables.

FY 2006 – Excluding current maturities on long-term debt, current liabilities increased \$72.0 million, from \$184.2 million as of January 31, 2005, to \$256.2 million as of January 31, 2006. The overall rise was due to increases in numerous categories, including the following: elevated vendor payables of \$34.1 million related primarily to construction of the Spruce 2 power plant, increased natural gas purchases of \$14.8 million, a rise in STP operation payable of \$12.1 million due mainly to CPS Energy's larger ownership interest, higher employee-related liabilities of \$9.7 million and an increased payable to the City of \$8.2 million. Partially offsetting the increases were reduced liabilities of \$9.5 million for purchased power.

Other Noncurrent Liabilities (Excluding Debt)

FY 2007 – Excluding the noncurrent portion of debt, long-term liabilities increased \$127.2 million, from \$983.4 million as of January 31, 2006, to \$1.1 billion as of January 31, 2007. This increase was due primarily to a \$110.0 million increase in cash collateral from securities lending for the Decommissioning Trusts and a \$37.1 million increase in STP decommissioning obligation. This increase was partially offset by the June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$ 725.0 million deferred lease revenue is being amortized over 32 years.

FY 2006 – Excluding the noncurrent portion of debt, long-term liabilities increased \$86.9 million, from \$896.5 million as of January 31, 2005, to \$983.4 million as of January 31, 2006. This increase was due primarily to a higher decommissioning obligation of \$78.7 million associated with the added 12% ownership interest in STP. Additional increases resulted from a rise of \$11.3 million in pension-related costs also due to CPS Energy's increased ownership in STP and \$15.8 million in increased fuel hedges. These increases were partially offset by the June 2000 lease/leaseback transaction for CPS Energy's Spruce 1 property, whereby \$725.0 million of deferred lease revenue is being amortized over approximately 32 years.

FINANCING AND DEBT COVENANTS COMPLIANCE

Long-Term Debt (Excluding Tax-Exempt Commercial Paper)

FY 2007 – Issuance – On August 31, 2006, CPS Energy issued \$384.2 million of tax-exempt New Series 2006A Revenue Bonds. These bonds were partially used to reimburse the Repair and Replacement Account for construction expenditures incurred during the months of February through July 2006 in the amount of \$131.2 million. The \$268.8 million remaining proceeds and net original issue premium will be used to fund generation, and electric and gas distribution construction projects.

Defeasance – On August 11, 2006, \$106.4 million of New Series 1997 Revenue and Refunding Bonds were legally defeased with cash. Under this defeasance, the debt obligations have been technically voided, as the cash has been escrowed with a third party to service the debt. As a result, an accounting loss of \$7.2 million was recorded. The basis of the loss calculation included \$107.8 million paid for the actual defeasance; less the par value of debt; plus unamortized bond issue, reacquisition and premium/discount costs.

Other Reductions – In addition to the cash defeasance that reduced debt, CPS Energy also made principal payments during the fiscal year.

Summary of Debt Rollforward Activity

(In thousands)

Fiscal Year 2007			
Balance Outstanding February 1, 2006	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2007
\$ 2,967,885	\$ 384,185	\$ (241,215)	\$ 3,110,855

FY 2006 – Issuance – For FY 2006, a total of \$732.6 million in bonds was issued. In October 2005, \$197.3 million in New Series 2005A Revenue Refunding Bonds were issued. These bonds were used to refund \$200.0 million of CPS Energy's outstanding Tax-Exempt Commercial Paper ("TECP").

In April 2005, CPS Energy issued \$294.6 million and \$240.7 million in New Series 2005 Revenue Refunding Bonds and New Series 2005 Revenue Bonds, respectively. The former instruments refunded outstanding revenue bonds for a net present value debt service savings of \$19.7 million, while the latter instruments were issued to fund transmission, electric distribution, information technology and communication, and general property construction.

Redemption – Included in the decreases for the fiscal year was a redemption. On December 1, 2005, CPS Energy opted to redeem \$3.0 million of the 2004 VRDOs' principal and then remarket the remaining \$157.0 million of the bonds for a two-year term at an interest rate of 3.6% per annum.

Other Reductions – In addition to the redemption that reduced debt, CPS Energy also made principal payments during the fiscal year.

Summary of Debt Rollforward Activity

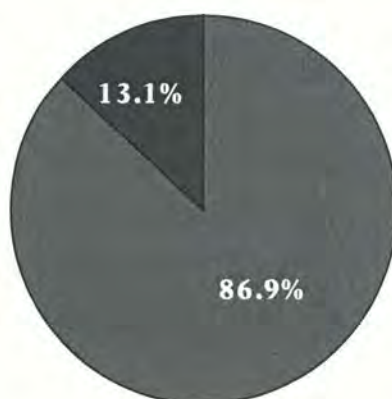
(In thousands)

Fiscal Year 2006			
Balance Outstanding February 1, 2005	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2006
\$ 2,661,225	\$ 732,635	\$ (425,975)	\$ 2,967,885

Existing Debt

At January 31, 2007, CPS Energy's total debt was \$3.1 billion, excluding commercial paper. This long-term debt was comprised of \$2.7 billion in fixed-interest-rate instruments and \$407.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt varied from 2.3% on the 2003 tax-exempt bonds to 7.4% on the 2000B taxable bonds, with an overall weighted-average yield of 4.8%. Separately, the variable-rate debt had a blended interest rate of 3.5%. Interest rates on New Series Bonds declined slightly in FY 2007 due to implemented financing strategies and refunding transactions.

**Allocation of Debt
at January 31, 2007**



**Allocation of Debt
at January 31, 2006**



■ Fixed-Rate Instruments ■ Variable-Rate Instruments

Note: Graphs exclude Tax-Exempt Commercial Paper

At January 31, 2006, CPS Energy's total debt was \$3.0 billion, excluding commercial paper. This long-term debt was comprised of \$2.6 billion in fixed-interest-rate instruments and \$407.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt varied from 2.3% on the 2003 tax-exempt bonds to 7.4% on the 2000B taxable bonds, with an overall weighted-average yield of 4.9%. Separately, the variable-rate debt had a blended interest rate of 3.3%.

Tax-Exempt Commercial Paper

CPS Energy maintains a TECP program to provide tax-exempt financing for various purposes. The program is currently authorized to have notes outstanding in an amount not to exceed \$450.0 million. CPS Energy replaced the TECP liquidity facility, effective November 1, 2004, for a three-year term. Effective January 1, 2006, CPS Energy extended the TECP liquidity facility's term to November 1, 2010.

FY 2007 – Issuance – On August 24, 2006, CPS Energy issued \$200.0 million of TECP that will be used to fund generation, as well as electric and gas distribution construction projects.

Summary TECP Rollforward Activity

(In thousands)

Fiscal Year 2007			
Balance Outstanding February 1, 2006	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2007
\$ 150,000	\$ 200,000	\$ -	\$ 350,000

FY 2006 – Redemption – On October 27, 2005, CPS Energy issued \$197.3 million of New Series 2005A Revenue Refunding Bonds to redeem \$200.0 million of the outstanding TECP.

Summary TECP Rollforward Activity

(In thousands)

Fiscal Year 2006			
Balance Outstanding February 1, 2005	Additions During Year	(Decreases) During Year	Balance Outstanding January 31, 2006
\$ 350,000	\$ -	\$ (200,000)	\$ 150,000

Compliance

With respect to all New Series Bonds outstanding at January 31, 2007, the net revenues of the electric and gas systems ("Systems") are pledged to the payment of principal and interest thereon. All New Series Bonds are issued as Senior Lien Obligations, and the principal and interest thereon have a first lien upon the net revenues of CPS Energy's Systems.

The VRDOs are issued as Junior Lien Obligations. The borrowings from the Junior Lien Obligations are equally and ratably secured by and payable from the net revenues of CPS Energy's Systems, such pledge being subordinate and inferior to the pledge of net revenues securing the Senior Lien Obligations, but prior and superior to the lien on, and pledge of, the net revenues securing the payment of the TECP Notes.

The total amount outstanding of Senior Lien Obligations, including current maturities, was \$2.7 billion at January 31, 2007, and \$2.6 billion at January 31, 2006. The total amount outstanding of Junior Lien Obligations was \$407.0 million at January 31, 2007 and 2006.

The current TECP revolving credit agreement permits CPS Energy to borrow up to an aggregate amount not to exceed \$350.0 million for the purpose of paying amounts due under the TECP program. The TECP outstanding is also secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of Senior Lien and Junior Lien Obligations. After an issuance of \$200.0 million in TECP, the balance outstanding was \$350.0 million at January 31, 2007.

As of January 31, 2007, and January 31, 2006, CPS Energy was in compliance with the terms and provisions of the documents related to the New Series Bonds, the VRDOs and the TECP.

Debt Service Coverage

CPS Energy's debt service coverage ratio for the New Series Bonds, in accordance with the ordinances, was 2.64x for FY 2007 and 2.72x for FY 2006. The ratio of fund net assets to total debt and fund net assets was 45.8% at January 31, 2007, as compared to 47.5% at January 31, 2006. Both of these ratios exclude the Employee Benefit Plans.

The weighted-average interest rate on outstanding commercial paper was 3.1% at January 31, 2006, and rose to 3.6% at January 31, 2007. The weighted-average maturity of commercial paper at January 31, 2007, and January 31, 2006, was 90 and 96 days, respectively.

Summary of CPS Energy's Bond and Commercial Paper Ratings

	Ratings at January 31, 2007		
	Senior Lien Debt	Junior Lien Debt	TECP
Fitch Ratings	AA+	AA+ / F1+	F1+
Moody's Investors Service, Inc.	Aa1	Aa2 / VMIG 1	P-1
Standard & Poor's Ratings Services	AA	AA- / A-1+	A-1+

OPERATIONAL CHANGES

In 1997, a Joint Operations Agreement ("JOA") between a predecessor of Texas Genco and CPS Energy was arranged to leverage the most efficient generating plants and favorable fuel prices of each utility—other than those related to STP. Under the agreement, Texas Genco scheduled each utility's resources with ERCOT. Due to changes in market conditions and the ERCOT market structure, Texas Genco terminated the agreement as of January 24, 2006.

Effective January 25, 2006, functioning as a Qualified Scheduling Entity ("QSE"), CPS Energy began directly representing its generation and load in the Texas energy marketplace. CPS Energy completed the necessary representations to ERCOT, incorporating business processes and implementing computer systems to support its expanded role. The systems implemented include load forecasting, plant commitment, ERCOT dispatch communications, generation control, wholesale transaction management, scheduling and ERCOT settlement.

Under the JOA, CPS Energy's share of the operational savings, including ERCOT settlements, was recorded to contributed capital. Due to CPS Energy's new QSE status, where it actively markets and schedules its own additional available resources, ERCOT settlements have been recorded to operations.

OTHER CURRENTLY KNOWN FACTS

On June 28, 2006, NRG Energy, Inc. announced plans to construct two additional reactors at the currently functioning two-unit STP site. With this addition, energy production is projected to increase by 2,700 megawatts. NRG Energy, Inc. filed a letter of intent with the Nuclear Regulatory Commission on June 19, 2006, and will proceed with the permitting and development of the new units. CPS Energy, as a current co-owner of the existing site, has an option to participate in this new construction project and is currently conducting its own feasibility study to help determine which course of action is in the best long-term interest of its customers.

In September 2006, the CPS Energy Board of Trustees authorized the sale of the lignite properties in Lee and Bastrop counties. On April 13, 2007, CPS Energy signed a Purchase and Sale Contract with a third party for the sale of the lignite properties.

In December 2006, CPS Energy's Board of Trustees authorized participation in a proposed joint venture with Austin Energy to build a power-generating complex. The complex could begin operating by 2017 and would eventually produce 3,000 megawatts of electricity.

On February 8, 2007, CPS Energy issued \$128.9 million of tax-exempt New Series 2006B Revenue Refunding Bonds. The true interest cost on these bonds was 4.0%. On February 9, 2007, the bond proceeds were used to refund \$77.1 million par value of the taxable New Series 1998B Bonds and \$41.7 million par value of the taxable New Series 2000B Bonds. At that time, CPS Energy cash defeased \$6.5 million par value of the taxable New Series 1998B Bonds that could not be advance refunded with tax-exempt debt. The refunding transaction resulted in net present value debt service savings of \$6.7 million, or 5.3% of the par amount of the bonds refunded.

REQUESTS FOR INFORMATION

For more information about CPS Energy, contact Robert G. McCullough, Director of Corporate Communications, at 210-353-2344 or at P.O. Box 1771, San Antonio, Texas 78296-1771.



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Independent Auditors' Report

The Board of Trustees
City Public Service of San Antonio, Texas:

We have audited the accompanying balance sheets of City Public Service of San Antonio, Texas (CPS Energy), a component unit of the City of San Antonio, Texas, as of January 31, 2007 and 2006, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of CPS Energy's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of City Public Service Employees' Pension Plan in 2007 or 2006 or the financial statements of the City Public Service Disability Income, Group Life Insurance and Group Health Plans (Employee Health and Welfare Plans) in 2007 or 2006. The financial information related to the City Public Service Employees' Pension Plan is included in footnote 8 of the notes to the financial statements. As of January 31, 2007 and 2006, the total assets and net assets of the Employee Health and Welfare Plans represent 2% and 3%, respectively, of the total assets and 7% and 6%, respectively, of the total fund net assets of CPS Energy. Those financial statements were audited by other auditors, for the years indicated, whose reports thereon have been furnished to us, and our opinion on the CPS Energy financial statements, insofar as it relates to the amounts and disclosures included for the City Public Service Employees' Pension Plan and the City Public Service Employee Health and Welfare Plans is based solely on the reports of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of CPS Energy as of January 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 8 through 23 and the schedule of funding progress in footnote 8 of the notes to the financial statements are not a required part of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We, and the other auditors, have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we, and the other auditors, did not audit the information and express no opinion on it.

KPMG LLP Robert Williams CPA Garza, Ruiz & Co., LLC

April 17, 2007

BALANCE SHEETS

	January 31,	
	2007	2006
	(In thousands)	
Assets		
Current assets		
Cash and cash equivalents	\$ 41,344	\$ 96,548
Cash collateral from securities lending	626,370	-
Investments	270,009	145,993
Interest and other receivables	22,513	36,091
Customer accounts receivable, less allowance for doubtful accounts of \$9.7 million at January 31, 2007, and \$8.5 million at January 31, 2006 <i>(includes unbilled revenue of \$37.6 million for January 2007 and \$15.2 million for January 2006)</i>	151,279	117,071
Inventories, at average costs		
Materials and supplies	89,758	87,045
Fossil fuels	43,252	62,500
Prepayments, deferred and other	50,050	55,057
Total current assets	<u>1,294,575</u>	<u>600,305</u>
Noncurrent assets		
Restricted		
Cash and cash equivalents	220,815	53,830
Investments	1,312,496	1,204,539
Interest receivable	7,691	7,187
Prepaid rent – leaseback	476,603	496,392
Other deferred costs	37,414	28,016
Capital assets, net	5,294,792	4,942,636
Total noncurrent assets	<u>7,349,811</u>	<u>6,732,600</u>
Total assets	<u>\$ 8,644,386</u>	<u>\$ 7,332,905</u>
Liabilities		
Current liabilities		
Current maturities of revenue bonds	\$ 141,755	\$ 135,155
Accounts payable and accrued liabilities	314,696	256,176
Securities lending obligation	626,370	-
Total current liabilities	<u>1,082,821</u>	<u>391,331</u>
Noncurrent liabilities		
Long-term debt, net	3,327,551	2,963,596
Decommissioning	448,157	301,072
Deferred lease revenue	543,333	565,893
Other noncurrent liabilities & deferred credits	94,343	94,111
Customer deposits	24,785	22,363
Total noncurrent liabilities	<u>4,438,169</u>	<u>3,947,035</u>
Total liabilities	<u>5,520,990</u>	<u>4,338,366</u>
Fund net assets		
Invested in capital assets, net of related debt	2,118,261	1,949,167
Restricted		
Debt service	5,984	3,582
Ordinance	583,809	666,010
Employee benefit plans	203,127	177,980
Unrestricted	212,215	197,800
Total fund net assets	<u>3,123,396</u>	<u>2,994,539</u>
Total liabilities and fund net assets	<u>\$ 8,644,386</u>	<u>\$ 7,332,905</u>

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	Fiscal Year Ended January 31,	
	2007	2006
	(In thousands)	
Operating revenues		
Electric	\$ 1,515,746	\$ 1,437,798
Gas	254,340	244,921
Total operating revenues	<u>1,770,086</u>	<u>1,682,719</u>
Operating expenses		
Fuel, purchased power and distribution gas	659,839	638,636
STP operation and maintenance	115,269	101,735
Other operation and maintenance	260,569	242,963
Employee benefit plans	25,513	27,820
Regulatory assessments	28,645	37,083
Decommissioning	32,721	10,207
Depreciation and depletion	262,375	246,410
Total operating expenses	<u>1,384,931</u>	<u>1,304,854</u>
Operating income	<u>385,155</u>	<u>377,865</u>
Nonoperating income (expense)		
Interest and other income, net	74,980	48,906
Decommissioning trusts investment income and change in fair market value	28,341	5,827
Employee benefit plans investment income and change in fair market value	18,373	2,486
Interest expense	(161,268)	(149,370)
Amortization of debt reacquisition, issuance, discount and other costs	(4,811)	(8,872)
Allowance for funds used during construction	16,460	4,669
Costs for cash defeasance of debt	(7,243)	-
Payments to the City of San Antonio	(235,898)	(227,178)
Total nonoperating income (expense)	<u>(271,066)</u>	<u>(323,532)</u>
Income before other changes in fund net assets	114,089	54,333
Other transfers to the City of San Antonio	(9,594)	(8,639)
Contributed capital	22,857	63,421
Adjustment for STP pension cost	1,505	(177)
Change in fund net assets	<u>128,857</u>	<u>108,938</u>
Fund net assets – beginning	2,994,539	2,885,601
Fund net assets – ending	<u>\$ 3,123,396</u>	<u>\$ 2,994,539</u>

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF CASH FLOWS

	Fiscal Year Ended January 31,	
	2007	2006
	(In thousands)	
Cash flows from operating activities		
Cash received from customers	\$ 1,750,796	\$ 1,695,703
Cash payments to suppliers for goods and services	(821,612)	(827,805)
Cash payments to employees for service	(164,648)	(163,997)
Net cash provided (used) by operating activities	764,536	703,901
Cash flows from capital and related financing activities		
Cash paid for additions to utility plant and net removal costs	(587,565)	(514,302)
Cash paid for nuclear fuel purchases	(36,174)	(45,636)
Contributed capital	22,857	63,421
Proceeds from issuance of revenue bonds	384,185	222,590
Proceeds from issuance of commercial paper	200,000	-
Premium received from revenue bonds issued	18,452	34,437
Principal payments on revenue bonds and cash defeasance of debt	(241,215)	(130,255)
Interest paid	(159,477)	(148,961)
Debt issue and cash defeasance costs paid	(3,907)	(7,171)
Net cash provided (used) by capital and related financing activities	(402,844)	(525,877)
Cash flows from noncapital financing activities		
Cash payments to the City of San Antonio	(241,439)	(227,126)
Net cash provided (used) by noncapital financing activities	(241,439)	(227,126)
Cash flows from investing activities		
Purchases of investments	(1,417,454)	(1,117,219)
Proceeds from sales and maturities of investments	1,277,421	1,093,819
Net cash increase (decrease) in decommissioning trusts assets	(25,709)	13,189
Net cash increase (decrease) in employee benefit plans assets	(1,959)	(5,075)
Interest and other income	49,206	43,553
Net cash provided (used) by investing activities	(118,495)	28,267
Net increase (decrease) in cash and cash equivalents	1,758	(20,835)
Cash and cash equivalents at beginning of period	150,378	171,213
Cash and cash equivalents at end of period	\$ 152,136	\$ 150,378
Reconciliation of operating income to net cash provided by operating activities		
Cash flows from operating activities		
Operating income	\$ 385,155	\$ 377,865
Noncash items included		
Depreciation and depletion expenses	262,375	246,410
Nuclear fuel amortization	25,668	21,555
Provision for doubtful accounts	7,687	6,083
Changes in current assets and liabilities		
(Increase) decrease in customer accounts receivable, net	(41,895)	13,682
(Increase) decrease in other receivables	12,496	(9,725)
(Increase) decrease in materials and supplies	(2,713)	(14,579)
(Increase) decrease in fossil fuels	19,248	(19,694)
(Increase) decrease in prepayments, deferred and other	5,007	(24,106)
Increase (decrease) in accounts payable and accrued liabilities	55,663	63,337
Changes in noncurrent and other assets and liabilities		
(Increase) decrease in other noncurrent assets and deferred costs	(6,238)	2,573
Increase (decrease) in customer service deposits payable	2,422	2,944
Increase (decrease) in decommissioning trusts liability	40,524	10,191
Increase (decrease) in employee benefit plans liability	(1,095)	(525)
Increase (decrease) in noncurrent liabilities and deferred credits	232	27,890
Net cash provided (used) by operating activities	\$ 764,536	\$ 703,901

See accompanying Notes to Basic Financial Statements.

NOTES TO BASIC FINANCIAL STATEMENTS

January 31, 2007, and January 31, 2006

1. Summary of Significant Accounting Policies

Reporting Entity – City Public Service of San Antonio (also referred to as “CPS Energy,” “CPS” or the “Company”) is a municipal utility owned by the City of San Antonio, Texas (“City”) since 1942. It provides electricity and natural gas to San Antonio and surrounding areas. As a municipal utility, CPS Energy is exempt from the payment of income taxes, state franchise taxes, sales taxes, and real and personal property taxes. CPS Energy provides certain payments and benefits to the City as permitted by bond ordinances. CPS Energy’s financial results are also included within the comprehensive annual financial report of the City.

The decision to include applicable component units in CPS Energy’s financial statements was made by applying the criteria set forth in the Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*. Accordingly, the reporting entity reflected in these financial statements consists of CPS Energy’s financials and certain component units, which are legally separate, but for which CPS Energy is financially accountable.

The relationships among the component units and CPS Energy meet the criteria as set forth in GASB Statement No. 14. Accordingly, the financial statements of the following components are blended with those of CPS Energy:

- **Decommissioning Trusts** – The City Public Service Restated Decommissioning Master Trust for the South Texas Project (“28% Decommissioning Trust”) and the City Public Service Decommissioning Master Trust (TCC Funded) (“12% Decommissioning Trust”), herein collectively referred to as the Decommissioning Trusts.
- **Employee Benefit Plans** – The City Public Service of San Antonio Disability Income, the Group Life Insurance and the Group Health Plans, herein collectively referred to as the Employee Benefit Plans.

Within these financial statements are the applicable financial results for 40% of the South Texas Project (“STP”).

The financial statements of CPS Energy’s Pension Plan are separately audited and reported. According to the GASB Staff Implementation Guide for GASB Statement No. 14, if an entity is acting in a trustee capacity in regard to its pension plan, the assets of the pension plan should not be evaluated as a potential component unit, but should be reported separately. CPS Energy, through its Oversight Committee and Administrative Committee, acts in a trustee capacity for the Pension Plan. Therefore, consistent with the GASB Statement No. 14 Implementation Guide, the Pension Plan has not been categorized as a component unit of CPS Energy. The financial results are not included herein except for certain disclosures as provided in Note 8 – Employee Pension Plan.

Fiscal Year – Notwithstanding interim measurement dates where referenced specifically, the fiscal year ended January 31, 2007, is referred to herein as FY 2007. The fiscal years ended January 31, 2006, and January 31, 2005, are referred to herein as FY 2006 and FY 2005, respectively.

Basis of Accounting – The financial statements of CPS Energy are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) for proprietary funds of governmental entities. CPS Energy, including the Employee Benefit Plans and Decommissioning Trusts, complies with all applicable pronouncements of GASB. In accordance with GASB Statement No. 20, *Accounting and*

Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting. CPS Energy has elected not to follow the pronouncements of the Financial Accounting Standards Board ("FASB") issued after November 30, 1989.

STP is a nonprofit special-purpose entity that reports under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to STP's financial information within CPS Energy's financial statements for these differences.

CPS Energy FY 2007 Pronouncement Implementations:

- GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The statement establishes uniform standards of financial reporting for other postemployment benefit ("OPEB") plans. The statement establishes disclosure requirements for both the Employee Benefit Plans and employer financial statements. Disclosure requirements for the employer have been incorporated into Note 9 – Employee and Other Postemployment Benefits.
- GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Provisions of Medicare Part D*. The technical bulletin clarifies the application of existing standards of accounting and financial reporting to payments received by an employer or directly by OPEB Plans from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D. Those disclosures applicable to the employer, which are required with the implementation of GASB Statement No. 43, have been incorporated into Note 9 – Employee and Other Postemployment Benefits.

CPS Energy FY 2006 Pronouncement Implementations:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The statement provides guidance for determining if any assets have been impaired and for calculating the appropriate write-downs in value for any assets found to be impaired. The statement also provides guidance for accounting for any insurance proceeds received for impaired capital assets. For additional information, see Note 4 – Capital Assets, Net.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*. The statement requires governments to disclose the portion of total net assets restricted by enabling legislation. CPS Energy currently discloses restricted funds designated by law, ordinance or contract. As of January 31, 2007, and January 31, 2006, CPS Energy had no fund net assets restricted by enabling legislation.
- GASB Statement No. 47, *Accounting for Termination Benefits*. The statement requires that an employer recognize a liability and expense for voluntary and involuntary termination benefits. As of January 31, 2007, and January 31, 2006, CPS Energy had no termination benefits in place.

In accordance with the utility systems revenue bond ordinances, CPS Energy has adopted the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners. The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

Reclassifications – Certain amounts in the prior year's financial statements have been reclassified to conform to the current year presentation.

Revenues and Expenses – Revenues are recorded when earned. Customers' meters are read and bills are prepared monthly based on billing cycles. Rate schedules include adjustment clauses that permit recovery of electric fuel and gas costs. Since fiscal year ended January 31, 2004, CPS Energy has used historical information from the relative prior fiscal years as partial bases to estimate and record earned revenue not yet billed. This process has involved an extrapolation of customer usage over the days since the last meter read through the last day of the monthly period. The amounts of unbilled revenue receivable recorded at January 31, 2007, and January 31, 2006, including estimates for electric fuel and gas costs, were \$37.6 million and \$15.2 million, respectively.

CPS Energy's electric fuel cost adjustment clause also permits recovery of regulatory assessments. Specifically beginning in March 2000, CPS Energy began recovering assessments from the Public Utility Commission of Texas ("PUCT") for transmission access charges and from the Texas Independent System Operator, also known as the Electric Reliability Council of Texas ("ERCOT"), for its operating costs and other charges applicable to CPS Energy as a wholesale provider of power to other utilities. Regulatory assessments for FY 2007 and FY 2006 were \$28.6 million and \$37.1 million, respectively.

Operating revenues include receipts from energy sales and miscellaneous revenue related to the operation of electric and gas systems. Miscellaneous revenue includes late payment fees, rental income, jobbing and contract work, and ancillary services. Operating expenses are recorded as incurred and include those costs that result from the ongoing operations of the electric and gas systems.

Nonoperating revenue consists primarily of investment income, including fair market value adjustments. The amortization of net gains from the lease/leaseback of J.K. Spruce Unit 1 ("Spruce 1") and the sale of water rights, when applicable, are also included. Certain miscellaneous income amounts from renting general property and providing various services are also recorded as nonoperating when they are not directly identified with the electric or gas systems. These amounts for FY 2007 and FY 2006 were recorded net of expenses.

Capital Assets – The costs of additions and replacements of assets identified as major components or property units are capitalized. Maintenance and replacements of minor items are charged to operating expenses. Except for certain assets that may become impaired, the cost of depreciable plant retired, plus removal costs and less salvage, is charged to accumulated depreciation. Per the financial reporting requirements of GASB Statement No. 42, any losses associated with capital asset impairments will be charged to operations, not to accumulated depreciation.

Utility plant is stated at the cost of construction, including expenditures for contracted services; direct equipment, material and labor; indirect costs, including general engineering, labor, equipment and material overheads; and an allowance for funds used during construction ("AFUDC"), which represents capitalized interest. CPS Energy computes AFUDC using rates that approximate the cost of borrowed funds measured as the short-term investment rate for other funds used for construction. Noncash AFUDC is applied to projects estimated to require 30 days or more to complete.

Proceeds from customers and certain litigation settlements to partially fund construction expenditures are reported in the Statements of Revenues, Expenses and Changes in Fund Net Assets as increases in fund net assets in accordance with the requirements of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

Except for nuclear fuel, which is amortized over units of production, CPS Energy computes depreciation using the straight-line method over the estimated service lives of the depreciable property according to asset type. Total depreciation as a percent of total depreciable assets, excluding nuclear fuel, was 3.3% for both FY 2007 and FY 2006.

The estimated useful lives of capital assets for both FY 2007 and FY 2006 were as follows:

Buildings and structures	15-60 years
Systems and improvements	
Generation	8-45 years
Transmission and distribution	20-55 years
Gas	50-65 years
Machinery and equipment	4-30 years
Lignite mineral rights and other	20-40 years
Nuclear fuel	Units of Production

Cash Equivalents and Investments, Unrestricted and Restricted – CPS Energy's investments with a maturity date within one year of the purchase date are reported at amortized cost, which approximates fair value. Amortization of premium and accretion of discount are recorded over the terms of the investments that mature within one year. CPS Energy's investments with a maturity date of one year or longer from the purchase date are accounted for using fair value. Fair value is determined by using generally accepted financial reporting services, publications, dealers and brokers as necessary. The specific identification method is used to determine cost in computing gain or loss on sales of securities. CPS Energy reports all investments of the Decommissioning Trusts and the Employee Benefit Plans at fair market value.

Restricted funds are generally for uses other than current operations. They are designated by law, ordinance or contract and are often used to acquire or construct noncurrent assets. Restricted funds consist primarily of unspent bond or commercial paper proceeds, debt service required for the New Series Bonds and Junior Lien Obligations, and funds for future construction or contingencies. This category also includes customer assistance programs where proceeds are received from outside parties. The assets of the Decommissioning Trusts and the Employee Benefit Plans are also considered restricted.

The Repair and Replacement Account is restricted in accordance with the Company's bond ordinances. In compliance with an ordinance, CPS Energy's Board of Trustees authorized that a portion of the Repair and Replacement Account be designated for converting overhead electric facilities to underground (also referred to as Overhead Conversion Fund).

In January 2005, CPS Energy's Board of Trustees approved a policy to expand the use of the Overhead Conversion Fund. Beginning in FY 2006, the annual 1.0% funding was redesignated for Community Infrastructure and Economic Development ("CIED") projects. Additionally, the basis of the funding was modified to be 1.0% of the prior fiscal year's Electric Base Rate Revenue, which excludes certain items such as applicable fuel adjustments and regulatory fees. In general, the restricted CIED funds are to be used to support qualified capital projects that provide economic benefit within the communities served. At January 31, 2007, and January 31, 2006, all such appropriated funds were included with the assets restricted by bond ordinance.

As initiated in FY 2006, in lieu of CIED funding, the City may alternatively request an equivalent amount of general funds to be transferred for its use. In such cases, the amount previously designated for CIED funding is returned to the Repair and Replacement Account and general funds are transferred to the City. In accordance with bond ordinances, the combined total of direct distributions and City payments is limited to 14% of gross revenues.

In FY 2007, CPS Energy and the Decommissioning Trusts entered into agreements with Frost National Bank, a Texas-based financial institution, for the purpose of securities lending. The cash collateral received for loaned securities is reported as an asset on the Balance Sheet. The obligation for the cash collateral is reported on the Balance Sheet as a liability that directly offsets the amount received from

brokers or dealers in exchange for securities loaned. See Note 11 – Other Financial Instruments for details regarding securities lending.

See Note 2 – Cash, Cash Equivalents and Investments for additional disclosures that have been provided in accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. These disclosures address investment exposure to interest rate, concentration of credit, credit and foreign currency risks, as applicable.

Other Noncurrent Assets and Deferred Costs – In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon Corporation (“Exelon”), formerly known as Unicom Corporation. The long-term portion of prepaid rent related to this transaction was recorded as a deferred cost in the fiscal year ended January 31, 2001. In addition, \$12.3 million was paid to the City, in accordance with the New Series Bond Ordinances, for its 14% share of the net benefit from the transaction. This was recorded as a prepaid item and is being amortized over the life of the lease.

Noncurrent assets include unamortized debt-issuance expenses, which are amortized over the life of the bonds. Other assets include the long-term receivable from the San Antonio Water System for the sale of water rights in fiscal year 2000, as well as the restricted cash collateral from securities lending.

Long-Term Debt – To support its long-term capital financing needs, CPS Energy uses several types of debt instruments. As of January 31, 2007, and January 31, 2006, these included fixed-rate and variable-rate bonds, and commercial paper. Relative to the bond instruments, provisions may be included that allow for refunding after specified time periods during the bond term.

Current refundings involve issuing new debt (“refunding bonds”) to redeem existing debt (“refunded bonds”) that can be called within 90 days of issuing the refunding bonds. Advance refunding bonds involve issuing new debt to redeem existing debt that cannot be called within 90 days of issuing the refunding bonds. In these circumstances, the refunding bond proceeds are escrowed with a third party. These proceeds, and income thereon, are used to pay the debt service on the refunded bonds until the refunded bonds can be called. Deposit of the refunding bond proceeds with such a third party results in a legal defeasance of the refunded bonds, and these refunded bonds do not appear on the Balance Sheets. Refunding bonds are generally issued to achieve debt service savings.

For current and advance refundings, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a deduction or addition to the new debt liability. The deferred amount is amortized as a component of interest expense over the shorter remaining life of the refunding or the refunded debt.

Subject to applicable timing restrictions that may prevent early payoff, CPS Energy also has the option to defease or extinguish debt with cash. A bond defeasance occurs when cash is placed in an irrevocable trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, which fully discharges the bond issuer’s obligation.

At the time of an extinguishment with cash, since the issuer no longer has the legal obligation, the defeased debt is removed from the balance sheet, the related unamortized costs are expensed and the gain or loss is immediately recognized.

Other Noncurrent Liabilities and Deferred Credits – The long-term portion of the deferred revenue associated with the lease/leaseback was recorded as a deferred credit and is being amortized over the life of the lease.

Other liabilities and deferred credits include the obligations of the Decommissioning Trusts, customer service deposits, advance payments from customers for construction, the restricted cash collateral from

securities lending and the Department of Energy special assessments. The long-term portion of the payable to the Greater Kelly Development Authority ("GKDA") for the purchase of electric and gas properties in fiscal year ended January 31, 2000 has also been recorded in other liabilities. In FY 2006, GKDA changed its name to Port Authority of San Antonio.

Compensated Absences – Employees earn vacation benefits based upon their employment status and years of service. As of January 31, 2007, and January 31, 2006, the accruals for those vested benefits were \$13.8 million and \$12.7 million, respectively.

Inventories – CPS Energy maintains inventories for its materials and supplies and fossil fuels. In total, CPS Energy reported ending inventories of \$133.0 million and \$149.5 million at January 31, 2007, and January 31, 2006, respectively. Included in these amounts were CPS Energy's portion of STP inventories valued at \$41.2 million and \$38.4 million at the end of FY 2007 and FY 2006, respectively. STP values its inventories at the lower of average cost or net realizable value. CPS Energy's remaining directly managed inventories are valued using an average costing approach.

Statements of Cash Flows – For purposes of reporting cash flows, CPS Energy considers all highly liquid debt instruments purchased with an original maturity of 90 days or less to be cash equivalents. Noncash transactions have been excluded from CPS Energy's Statements of Cash Flows.

FY 2007 – The following is a summary of noncash investing, capital and related financing activities for FY 2007:

- In August 2006, a noncash accounting loss of \$6.1 million, representing unamortized bond issue, reacquisition and premium/discount costs, was recorded to nonoperating expense in connection with the cash defeasance of the New Series 1997 Revenue and Refunding Bonds.
- Securities lending cash collateral of \$626.4 million for CPS Energy and \$110.0 million for the Decommissioning Trusts was recorded as an asset with a corresponding liability for the obligation to repay the collateral.

FY 2006 – The following is a summary of noncash investing, capital and related financing activities for FY 2006:

- In April 2005, \$310.0 million in proceeds from the issuance of refunding bonds was directly deposited to an escrow account established for the exclusive purpose of refunding \$295.7 million in revenue bonds.
- In October 2005, \$200.0 million in proceeds from the issuance of refunding bonds was directly deposited to an escrow account established for the exclusive purpose of redeeming \$200.0 million in outstanding commercial paper.
- As part of the additional 12% acquisition of STP, CPS Energy assumed the 12% Decommissioning Trust assets of \$66.3 million from AEP Texas Central Company ("AEP"). A decommissioning trust liability in the same amount was also assumed.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the amounts of revenues and expenses reported during the fiscal periods. Accordingly, actual results could differ from those estimates.

2. Cash, Cash Equivalents and Investments

Investment Options – CPS Energy's cash deposits at January 31, 2007, and January 31, 2006, were entirely insured by federal depository insurance or collateralized by banks. For deposits that were collateralized, the securities were U.S. Government, U.S. Government Agency or U.S. Government-guaranteed obligations held in book entry form by Frost National Bank in CPS Energy's name.

Cash and Cash Equivalents

	January 31,	
	2007	2006
	(In thousands)	
Cash and cash equivalents		
Petty cash funds on hand	\$ 102	\$ 138
Bond paying agent – debt service – restricted	742	639
Deposits with financial institutions		
Unrestricted CPS deposits	68	10,011
Restricted CPS deposits		
Capital projects	14	1
Debt service	1,420	-
Project Warm	383	111
Employee benefit plans	51	608
Investments with original maturities of less than 90 days		
CPS unrestricted (current)	667,544	86,399
CPS restricted (noncurrent)	76,296	11,384
Decommissioning trusts – restricted (noncurrent)	120,283	23,739
Employee benefit plans – restricted (noncurrent)	21,626	17,348
Total cash and cash equivalents	<u>\$ 888,529</u>	<u>\$ 150,378</u>

Separation – CPS Energy's cash, cash equivalents and investments can be separated in the following manner:

- Those directly managed by CPS Energy,
- Those managed through the Decommissioning Trusts, and
- Those managed through the Employee Benefit Plans.

For financial reporting purposes, cash, cash equivalents and investments managed directly by CPS Energy have been consistently measured as of the end of the applicable fiscal years. The Decommissioning Trusts and the Employee Benefit Plans are reported on a calendar-year basis.

**Summary of Cash and Cash Equivalents,
Along with Current and Noncurrent Investments**

	January 31,	
	2007	2006
	(In thousands)	
Cash and cash equivalents		
CPS unrestricted and restricted	\$ 746,570	\$ 108,683
Decommissioning trusts – restricted	120,283	23,739
Employee benefit plans – restricted	21,676	17,956
Total cash and cash equivalents	<u>888,529</u>	<u>150,378</u>
Gross investments – current and noncurrent		
CPS unrestricted and restricted	1,815,166	1,007,602
Decommissioning trusts – restricted	447,104	300,343
Employee benefit plans – restricted	205,984	181,457
Total gross investments	<u>2,468,254</u>	<u>1,489,402</u>
Investments with original maturities of less than 90 days also included in cash equivalents		
CPS unrestricted and restricted	(743,840)	(97,783)
Decommissioning trusts – restricted	(120,283)	(23,739)
Employee benefit plans – restricted	(21,626)	(17,348)
Total	<u>(885,749)</u>	<u>(138,870)</u>
Net current and noncurrent investments	1,582,505	1,350,532
Total cash, cash equivalents and investments	<u>\$ 2,471,034</u>	<u>\$ 1,500,910</u>

Public Funds Investment Act (“PFIA”) – CPS Energy’s direct investments and the investments held in the Decommissioning Trusts are subject to the rules and regulations of the PFIA. The PFIA regulates what types of investments can be made, requires written investment policies, mandates training requirements of investment officers, requires internal management reports to be produced at least quarterly, and provides for the selection of authorized brokers. In September 2005, the PFIA was amended to allow the decommissioning trust funds for municipally owned nuclear power plants to hold investments authorized by Subtitle B, Title 9, of the Property Code (i.e., corporate bonds and equities such as common stocks).

Direct Investments of CPS Energy – CPS Energy’s allowable direct investments are defined by CPS Energy Board Resolution, CPS Energy Investment Policy, Bond Ordinances, Tax-Exempt Commercial Paper (“TECP”) Ordinance and state law. These investments are subject to market risk, and their market value will vary as interest rates fluctuate. All CPS Energy direct investments are held in trust custodial funds by an independent bank.

Investments of the Decommissioning Trusts – CPS Energy’s investments in the Decommissioning Trusts are held by an independent trustee. Investments are limited to those defined by CPS Energy Board Resolution, the South Texas Project Decommissioning Trust Investment Policy, the Investment Strategy Committee, the Trust Agreements and state law. Allowable investments for the Decommissioning Trusts include those mentioned above as directly permissible for CPS Energy, as well as equities and corporate bonds. Specifically, starting in September 2005, in accordance with the applicable amended investment policies, equity investments held can comprise 60.0% of total investments.

Investments of the Employee Benefit Plans – Investments in the Employee Benefit Plans are also held by an independent trustee. With the exception of real estates, these investments are limited to the same types mentioned above as authorized by the plans’ Administrative Committees, the Trust

Agreements and state law. Equity investments can comprise 60.0% of total investments in the health plan and can comprise 65.0% of total investments in the disability and life plans.

Permissible Investments

Investment Description	CPS Energy Direct Investments	Decommissioning Trusts	Employee Benefit Plans
U.S. government, government agency, or U.S. government-guaranteed obligations	•	•	•
Collateralized mortgage obligations issued by the U.S.	•	•	•
Fully secured certificates of deposit issued by a state, national or savings bank domiciled in the state of Texas	•	•	•
Direct repurchase agreements	•	•	•
Reverse repurchase agreements	•	•	•
Defined bankers acceptances and commercial paper	•	•	•
No-load money market mutual funds	•	•	•
Other specific types of secured or guaranteed investments	•	•	•
Equities	N/A	•	•
Corporate bonds	N/A	•	•
International securities	N/A	•	•
Securities lending	•	•	•
Real Estate	N/A	N/A	•

Cash, Cash Equivalents and Investments by Fund

	January 31,	
	2007	2006
	(In thousands)	
Unrestricted		
Cash and cash equivalents	\$ 667,714	\$ 96,548
Investments	270,009	145,993
Total unrestricted (current)	937,723	242,541
Restricted		
Debt service		
Cash and cash equivalents	5,963	685
Investments	-	2,895
Total debt service	5,963	3,580
Capital projects		
Cash and cash equivalents	14	1
Investments	285,042	103,174
Total capital projects	285,056	103,175
Ordinance		
Cash and cash equivalents	72,496	11,338
Investments	508,972	650,525
Total ordinance	581,468	661,863
Project Warm		
Cash and cash equivalents	383	111
Investments	7,302	7,232
Total Project Warm	7,685	7,343
Decommissioning trusts		
Cash and cash equivalents	120,283	23,739
Investments	326,821	276,604
Total decommissioning trusts	447,104	300,343
Employee benefit plans		
Cash and cash equivalents	21,676	17,956
Investments	184,359	164,109
Total employee benefit plans	206,035	182,065
Total restricted		
Cash and cash equivalents	220,815	53,830
Investments	1,312,496	1,204,539
Total restricted (noncurrent)	1,533,311	1,258,369
Total cash, cash equivalents and investments – unrestricted and restricted	\$ 2,471,034	\$ 1,500,910

Risk Exposure – Cash equivalents and fixed-income investments are exposed to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk. Interest rate risk is the exposure to fair market value losses resulting from rising interest rates. Credit risk is the risk that an issuer of an investment will not fulfill its obligations (will be unable to make timely principal and interest payments on the security). Foreign currency risk is the exposure to fair market value losses arising from changes in exchange rates. Cash, cash equivalents and fixed-income investments are also exposed to inflation, liquidity, political, legal, event, reinvestment and timing (call) risk. Additionally, equity investments are exposed to political, legal, event and general economic risk.

CPS Energy identifies and manages all of these risks by following an appropriate investment oversight strategy, establishing and monitoring compliance with investment policies and procedures, and continually monitoring prudent controls over risks. All investment policies follow the “prudent person” concept.

Summary of Investments by Organizational Structure and Type

	January 31,	
	2007	2006
	(In thousands)	
CPS investments		
U.S. Treasury, Government Agencies and money market funds*	\$ 1,815,166	\$ 1,007,602
Decommissioning trusts		
U.S. Treasury, Government Agencies and money market funds	224,912	143,095
Corporate bonds	42,920	20,149
Foreign bonds	1,576	843
Subtotal*	269,408	164,087
Common stock	177,696	136,256
Total decommissioning trusts	447,104	300,343
Employee benefit plans		
Money market mutual funds	21,626	17,348
Corporate bonds	19,504	26,989
Foreign bonds	8,876	8,282
U.S. Treasury and Government Agencies securities	29,047	18,208
Subtotal*	79,053	70,827
Common stock	111,457	100,894
International equities	6,956	1,300
Real estate	8,518	8,436
Total employee benefit plans	205,984	181,457
Grand total - all investments	\$ 2,468,254	\$ 1,489,402

*These items are subject to GASB Statement No. 40 evaluation, as provided below.

Investment Policies and the Adoption of GASB Statement No. 40 – Effective September 1, 2005, the investment policies of the Decommissioning Trusts were revised to allow for investment in additional types of securities, such as corporate bonds and equity securities. The policies provide guidelines to ensure all funds are invested in authorized securities in order to earn a reasonable return. The primary emphasis is placed on long-term growth commensurate with the need to preserve the value of the assets and, at the time funds are needed for decommissioning costs, on liquidity. The investment policies continue to follow the “prudent person” concept.

In November 2005, the Oversight Committees of the Employee Benefit Plans formally adopted Statements of Investment Objectives, Policy, Guidelines, and Administrative and Review Procedures. The investment objectives of the plans are to preserve plan assets through investment diversification and the trading of high quality securities and to provide sufficient liquidity to pay plan benefits. These investment policies also follow the “prudent person” concept.

In accordance with GASB Statement No. 40, additional disclosures have been provided in this note that address investment exposure to interest rate, concentration of credit, credit and foreign currency risks, as applicable. The disclosure requirements of this GASB statement do not apply to equity securities or real estate since neither is directly or immediately exposed to these risks. CPS Energy and its component units do not have custodial credit risk, as all investments are held either by an independent trustee or bank and are in CPS Energy's and the component units' names.

CPS Energy Direct Investments

In accordance with GASB Statement No. 40, the following tables address interest rate risk exposure by investment type using the weighted-average maturity ("WAM") method, concentration of credit risk and credit risk. Since CPS Energy does not hold foreign instruments in its direct investments—those not held by a component unit—foreign currency risk is not applicable.

Interest rate risk – In accordance with its investment policy, CPS Energy manages exposure to fair market value losses resulting from rising interest rates by limiting the portfolio's WAM to two years or less. WAM is defined as the weighted-average time to return a dollar of principal. It is used as an estimate of the interest rate risk of a fixed-income investment. CPS Energy invests the cash collateral received from securities lending and other funds in money market mutual funds that have no fixed maturities. Accordingly, a WAM in terms of years for money market mutual funds is not applicable.

Concentration of credit risk – In accordance with its investment policy, CPS Energy manages exposure to concentration of credit risk through diversification and by limiting its investment in each government-sponsored entity to 50.0% and its investment in any nongovernment issuer to 5.0% of the total fixed-income portfolio.

(In thousands)

Investment Type	January 31, 2007				January 31, 2006			
	Carrying Value	Market Value	Allocation	Weighted-Average Maturity (Years)	Carrying Value	Market Value	Allocation	Weighted-Average Maturity (Years)
U.S. Agencies								
Federal Home Loan Mortgage Corp	\$ 593,426	\$ 593,300	32.6%	0.4	\$ 230,231	\$ 230,145	22.8%	0.6
Federal National Mortgage Assn	421,804	421,785	23.1%	0.3	239,097	239,036	23.7%	0.5
Federal Home Loan Bank	131,066	131,037	7.2%	0.7	437,529	437,491	43.5%	0.5
Federal Farm Credit Bank	-	-	-	-	14,876	14,876	1.5%	0.4
Total fixed-income investments	1,146,296	1,146,122	62.9%	0.4	921,733	921,548	91.5%	0.5
Cash collateral - securities lending	626,370	626,370	34.7%	-	-	-	-	-
AIM money market	42,500	42,500	2.4%	-	85,869	85,869	8.5%	-
Total portfolio	\$ 1,815,166	\$ 1,814,992	100.0%	-	\$ 1,007,602	\$ 1,007,417	100.0%	-

Credit risk – In accordance with its investment policy, CPS Energy manages exposure to credit risk by limiting its fixed-income investments to a credit rating of "A" or better. As of January 31, 2007, and January 31, 2006, CPS Energy held no direct investments with a credit rating below "AAA."

(In thousands)

Credit Rating	January 31, 2007			January 31, 2006		
	Carrying Value	Market Value	Allocation	Carrying Value	Market Value	Allocation
AAA	\$ 1,815,166	\$ 1,814,992	100.0%	\$ 1,007,602	\$ 1,007,417	100.0%
Total fixed-income investments	\$ 1,815,166	\$ 1,814,992	100.0%	\$ 1,007,602	\$ 1,007,417	100.0%

Decommissioning Trusts Investments

As mentioned above, the Decommissioning Trusts report their assets on a calendar-year basis; therefore, the tables in this section are as of December 31.

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk. All investments held by the Decommissioning Trusts are long-term in nature and recorded at market value.

Interest rate risk – Generally, the long-term nature of the liabilities, and the limited need for daily operating liquidity, allows interim fluctuations in market value to occur without jeopardizing the ultimate value of the assets. Where long-term securities are held, the interim market value of assets can be sensitive to changes in interest rates. As the general level of interest rates moves up and down, the interim market value of longer-maturity bonds may change substantially. One of the techniques used to mitigate this risk is having a duration limitation. The overall portfolio duration should not deviate from the weighted-average duration of the Investment Strategy Committee's specified fixed-income index by more than +/- 1.5 years. The Investment Strategy Committee's fixed-income index is based on the Lehman Brothers Aggregate Index, which was 4.5 for 2006 and 4.6 for 2005.

Weighted-average duration is defined as the weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows and is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates.

Concentration of credit risk – In accordance with the investment policy, exposure to concentration of credit risk is managed through diversification and by limiting investments in each government-sponsored entity to 30.0% and investments in any nongovernment-sponsored issuer to 5.0% of the total fixed-income portfolio (excluding cash collateral from securities lending). At December 31, 2006, total nongovernment-sponsored (corporate and foreign) issuers amounted to 30.9% of the 28% Decommissioning Trust and 16.0% of the 12% Decommissioning Trust.

The following tables list the fixed-income investment holdings by type:

(In thousands)	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type – 28% Interest						
U.S. Treasuries	\$ 24,232	12.0%	3.3	\$ 60,584	44.7%	3.5
U.S. Agencies						
Federal National Mortgage Assn	32,727	16.2%	3.8	24,333	17.9%	4.1
Federal Home Loan Mortgage Corp	14,221	7.0%	3.4	10,148	7.5%	4.3
Small Business Admin	4,817	2.4%	3.1	1,880	1.4%	5.1
Federal Home Loan Bank	-	-	-	563	0.4%	1.8
Municipal bonds - Texas	305	0.1%	2.7	-	-	-
Municipal bonds - other states	1,776	0.9%	8.2	-	-	-
Corporate bonds	37,776	18.6%	6.0	14,860	10.9%	8.3
Foreign bonds	1,576	0.8%	11.3	843	0.6%	33.3
Total fixed-income investments	117,430	58.0%	4.5	113,211	83.4%	4.6
Cash collateral - securities lending	75,178	37.1%		-	-	
AIM money market	9,832	4.9%		22,475	16.6%	
Total portfolio	\$ 202,440	100.0%		\$ 135,686	100.0%	

(In thousands)

	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type – 12% Interest						
U.S. Treasuries	\$ 7,024	10.5%	5.4	\$ 5,902	20.8%	2.6
U.S. Agencies						
Federal Home Loan Mortgage Corp	6,132	9.2%	4.3	3,805	13.4%	5.5
Federal National Mortgage Assn	6,136	9.2%	4.0	5,497	19.4%	4.7
Government National Mortgage Assn	2,714	4.0%	4.0	1,348	4.7%	4.2
Municipal bonds - Texas	281	0.4%	7.7	684	2.4%	12.4
Municipal bonds - other states	4,264	6.4%	4.7	4,613	16.2%	5.6
Corporate bonds	5,144	7.7%	4.8	5,289	18.6%	4.3
Total fixed-income investments	31,695	47.4%	4.6	27,138	95.5%	4.5
Cash collateral - securities lending	34,845	52.0%		-	-	
AIM money market	428	0.6%		1,263	4.5%	
Total portfolio	\$ 66,968	100.0%		\$ 28,401	100.0%	

Credit risk – In accordance with the investment policies, exposure to credit risk is managed by limiting all fixed-income investments to a credit rating of “BBB-” or better from at least two nationally recognized credit rating agencies.

(In thousands)

	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – 28% Interest				
U.S. Treasuries	\$ 24,232	12.0%	\$ 60,584	44.7%
AAA	150,862	74.5%	59,931	44.2%
AA	140	0.1%	525	0.4%
A	12,376	6.1%	4,595	3.4%
BBB	14,830	7.3%	9,429	6.9%
Unrated - foreign bonds	-	-	622	0.4%
Total fixed-income investments	\$ 202,440	100.0%	\$ 135,686	100.0%

(In thousands)

	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – 12% Interest				
U.S. Treasuries	\$ 7,024	10.5%	\$ 5,902	20.8%
AAA	55,832	83.4%	18,744	66.0%
AA	1,282	1.9%	822	2.9%
A	2,233	3.3%	2,933	10.3%
BBB	597	0.9%	-	-
Total fixed-income investments	\$ 66,968	100.0%	\$ 28,401	100.0%

Foreign currency risk – With the exception of dedicated foreign-equity portfolios, all investments authorized for purchase by the Decommissioning Trusts are U.S. dollar-denominated. This, along with the low level of foreign fixed-income investment, reduced the potential currency risk exposure to the portfolio. Total foreign bonds outstanding—both rated and unrated—amounted to \$1.6 million as of December 31, 2006, and \$842.6 thousand as of December 31, 2005.

Employee Benefit Plan Investments

The Employee Benefit Plans consist of three separate plans:

- City Public Service of San Antonio Group Health Plan (“health plan”)
- City Public Service of San Antonio Disability Income Plan (“disability plan”)
- City Public Service of San Antonio Group Life Insurance Plan (“life plan”)

As mentioned above for the Decommissioning Trusts, the Employee Benefit Plans report their assets on a calendar-year basis; therefore, the tables in this section are as of December 31.

The Health Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk.

Interest rate risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to fair value losses resulting from rising interest rates by limiting the effective duration of each manager’s portfolio to +/- 1.5 years of the effective duration of the specified fixed-income index used as a benchmark for the investment manager’s portfolio. In addition, the duration of the aggregate fixed-income portfolio of the trust should not deviate from the duration of the specified fixed-income index used as a benchmark for the aggregate portfolio by more than +/- 1.5 years.

Effective duration is defined as the present value weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows. It is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates.

Concentration of credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee has established maximum holdings of other than federal government issuers so that in the event of failure of any one issuer it would not affect the entire investment portfolio. Further, exposure to credit risk is managed through diversification and by limiting the amount that may be invested in any one corporate bond issuer to 5.0% of the market value of an investment manager’s fixed-income portfolio. In addition, the maximum investment in any one corporate bond or note should not exceed 5.0% of the market value of the aggregate fixed-income portfolio. There is no such concentration restriction on the investment in government-guaranteed or government agency debt issues, other than government agency debt may not exceed 50.0% by any one issuer. There were no corporate bonds exceeding these limits at December 31, 2006, or December 31, 2005.

The following table lists the fixed-income investment holdings by type:

(In thousands)	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type - Health						
U.S. Treasuries	\$ 3,094	5.2%	7.7	\$ 4,196	8.0%	8.7
U.S. Agencies						
Federal National Mortgage Assn	6,376	10.7%	3.8	4,955	9.5%	4.0
Federal Home Loan Mortgage Corp	8,168	13.7%	3.4	2,564	4.9%	3.6
Federal Home Loan Bank	962	1.6%	3.9	147	0.3%	3.0
Government National Mortgage Assn	25	-	3.1	32	0.1%	2.7
Corporate bonds	14,925	25.0%	5.1	19,435	37.2%	5.4
Foreign bonds	6,481	10.9%	4.4	6,047	11.6%	4.5
Total fixed-income investments	40,031	67.1%	4.6	37,376	71.6%	5.3
AIM money market	19,654	32.9%		14,845	28.4%	
Total portfolio	\$ 59,685	100.0%		\$ 52,221	100.0%	
Specified fixed-income index:						
Lehman Brothers U.S. Aggregate Index			4.5			4.6
Citigroup High Yield Bond Index			4.5			4.6
Citigroup World Government Bond Index			6.0			5.9

Credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their total portfolio in bonds rated below BBB. The investment policy also authorizes the Administrative Committee to retain investment managers to manage “high yield” debt securities. The maximum allocation to high yield securities is 7.5% of total investments, which equated to 29.0% and 19.2% of total fixed-income investments at December 31, 2006, and December 31, 2005, respectively.

(In thousands)	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating - Health				
U.S. Treasuries	\$ 3,094	5.2%	\$ 4,196	8.0%
AAA	38,317	64.2%	31,180	59.7%
AA	1,610	2.7%	892	1.7%
A	2,318	3.9%	3,526	6.8%
BBB	1,239	2.0%	373	0.7%
Less than BBB	6,626	11.1%	6,007	11.5%
Navarro Investments, L.L.C. - see below	6,481	10.9%	6,047	11.6%
Total fixed-income investments	\$ 59,685	100.0%	\$ 52,221	100.0%

As noted above, even though at the end of calendar years 2006 and 2005, the health plan held approximately 10.9% and 11.6%, respectively, of its fixed-income investments in funds that were not rated by a rating agency, the majority of the underlying securities were rated. The following table reflects the weighting of the securities by market value (U.S. Dollars) and the corresponding ratings of the underlying securities at the end of 2006 and 2005. The weighted-average rating for those securities was calculated to be “AAA.”

(In thousands)

	December 31, 2006		December 31, 2005	
	Market Value	Allocation	Market Value	Allocation
Credit Rating – Navarro Investments, L.L.C.				
AAA	\$ 5,692	87.8%	\$ 5,482	90.6%
AA	439	6.8%	565	9.4%
Unrated	350	5.4%	-	-
Total – Navarro Investments, L.L.C.	<u>\$ 6,481</u>	<u>100.0%</u>	<u>\$ 6,047</u>	<u>100.0%</u>

Foreign currency risk – The historical guidelines and the investment policy place a 7.5% of total investment portfolio (fixed-income and equities) limit on the amount that may be invested in foreign-currency-denominated securities. The foreign currency risk is further mitigated by the investment guidelines in the fund.

(In thousands)

	December 31, 2006			December 31, 2005		
	Currency	Percentage of Total Portfolio	Market Value	Currency	Percentage of Total Portfolio	Market Value
Investment Type						
Foreign bond fund						
Navarro Investments, L.L.C.	\$ *	4.2%	\$ 6,481	\$ *	4.5%	\$ 6,047

*The currencies of the underlying investments include the British Pound, European Euro and Japanese Yen. The weighted-average rating of these securities is calculated to be "AAA."

The Disability Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk and concentration of credit risk. This plan does not hold foreign investments.

Interest rate risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the disability plan.

Concentration of credit risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the disability plan. The following table lists the fixed-income investment holdings by type:

(In thousands)

	December 31, 2006			December 31, 2005		
	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
Investment Type – Disability						
U.S. Treasuries	\$ 244	15.4%	6.5	\$ 299	19.5%	7.2
U.S. Agencies						
Federal National Mortgage Assn	391	24.7%	4.7	155	10.1%	3.0
Federal Home Loan Mortgage Corp	349	22.1%	3.6	91	6.0%	5.1
Federal Home Loan Bank	50	3.2%	5.5	26	1.7%	5.3
Government National Mortgage Assn	31	1.9%	4.5	35	2.3%	4.5
Corporate bonds	285	18.0%	4.7	654	42.8%	3.7
Total fixed-income investments	<u>1,350</u>	<u>85.3%</u>	<u>4.7</u>	<u>1,260</u>	<u>82.4%</u>	<u>4.6</u>
AIM money market	233	14.7%		269	17.6%	
Total portfolio	<u>\$ 1,583</u>	<u>100.0%</u>		<u>\$ 1,529</u>	<u>100.0%</u>	

Specified fixed-income index:

Lehman Brothers U.S. Aggregate Index

4.5

4.6

Credit risk – In accordance with its historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their portfolio in bonds rated below BBB.

(In thousands)	December 31, 2006		December 31, 2005	
Credit Rating – Disability	Market Value	Allocation	Market Value	Allocation
U.S. Treasuries	\$ 244	15.4%	\$ 299	19.6%
AAA	1,139	71.9%	950	62.1%
AA	25	1.6%	81	5.3%
A	108	6.8%	82	5.3%
BBB	67	4.3%	67	4.4%
Less than BBB	-	-	50	3.3%
Total fixed-income investments	<u>\$ 1,583</u>	<u>100.0%</u>	<u>\$ 1,529</u>	<u>100.0%</u>

The Life Plan

The following tables address interest rate risk exposure by investment type using the weighted-average duration method, credit risk, concentration of credit risk and foreign currency risk.

Interest rate risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the life plan.

Concentration of credit risk – The provisions as noted previously for the health plan were consistent with those herein applicable for the life plan. The following table lists the fixed-income investment holdings by type:

(In thousands)	December 31, 2006			December 31, 2005		
Investment Type – Life	Market Value	Allocation	Weighted-Average Duration (Years)	Market Value	Allocation	Weighted-Average Duration (Years)
U.S. Treasuries	\$ 1,551	8.7%	7.6	\$ 1,479	8.7%	7.6
U.S. Agencies						
Federal National Mortgage Assn	3,920	22.0%	4.1	2,660	15.6%	3.7
Federal Home Loan Mortgage Corp	3,720	20.9%	3.3	1,255	7.3%	3.7
Government National Mortgage Assn	92	0.5%	1.3	241	1.4%	1.2
Federal Home Loan Bank	74	0.4%	0.7	73	0.4%	1.6
Corporate bonds	4,294	24.1%	5.3	6,900	40.4%	6.5
Foreign bonds	2,395	13.5%	4.4	2,235	13.1%	4.5
Total fixed-income investments	<u>16,046</u>	<u>90.1%</u>	<u>4.6</u>	<u>14,843</u>	<u>86.9%</u>	<u>5.4</u>
AIM money market	1,739	9.9%		2,234	13.1%	
Total portfolio	<u>\$ 17,785</u>	<u>100.0%</u>		<u>\$ 17,077</u>	<u>100.0%</u>	

Specified fixed-income index:

Lehman Brothers U.S. Aggregate Index	4.5	4.6
Citigroup World Government Bond Index	6.0	5.9

Credit risk – In accordance with historical guidelines and the investment policy, the Administrative Committee manages exposure to credit risk by limiting high grade domestic debt managers to no more than 7.5% of their portfolio in bonds rated below BBB.

(In thousands)	December 31, 2006		December 31, 2005	
Credit Rating – Life	Market Value	Allocation	Market Value	Allocation
U.S. Treasuries	\$ 1,551	8.7%	\$ 1,479	8.7%
AAA	11,161	62.8%	11,009	64.5%
AA	816	4.6%	579	3.4%
A	1,357	7.6%	1,658	9.7%
BBB	505	2.8%	17	0.1%
Less than BBB	-	-	100	0.6%
Navarro Investments, L.L.C. - see below	2,395	13.5%	2,235	13.0%
Total fixed-income investments	<u>\$ 17,785</u>	<u>100.0%</u>	<u>\$ 17,077</u>	<u>100.0%</u>

As noted above, even though at the end of calendar years 2006 and 2005, the life plan held approximately 13.5% and 13.0%, respectively, of its fixed-income investments in funds that were not rated by a rating agency, the majority of the underlying securities were rated. The following table reflects the weighting of the securities by market value (U.S. Dollars) and the corresponding ratings of the underlying securities at the end of 2006 and 2005. The weighted-average rating for those securities was calculated to be “AAA.”

(In thousands)	December 31, 2006		December 31, 2005	
Credit Rating – Navarro Investments, L.L.C.	Market Value	Allocation	Market Value	Allocation
AAA	\$ 2,104	87.8%	\$ 2,026	90.6%
AA	162	6.8%	209	9.4%
Unrated	129	5.4%	-	-
Total – Navarro Investments, L.L.C.	<u>\$ 2,395</u>	<u>100.0%</u>	<u>\$ 2,235</u>	<u>100.0%</u>

Foreign currency risk – The historical guidelines and the investment policy place a 7.5% of total investment portfolio (fixed-income and equities) limit on the amount that may be invested in foreign-currency-denominated securities. The foreign currency risk is further mitigated by the investment guidelines in the fund.

(In thousands)	December 31, 2006			December 31, 2005		
Investment Type	Currency	Percentage of Total Portfolio	Market Value	Currency	Percentage of Total Portfolio	Market Value
Foreign bond fund						
Navarro Investments, L.L.C.	\$ *	5.1%	\$ 2,395	\$ *	5.1%	\$ 2,235

*The currencies of the underlying investments include the British Pound, European Euro and Japanese Yen. The weighted-average rating of these securities is calculated to be “AAA.”

3. Disaggregation of Current Receivables and Payables

Receivables – Net customer accounts receivable as of January 31, 2007, included \$37.6 million for unbilled revenue receivables and \$113.7 million for billed utility services. Interest and other receivables included \$5.1 million for regulatory-related receivables, \$3.7 million for interest receivable and \$13.7 million for other miscellaneous receivables.

Net customer accounts receivable as of January 31, 2006, included \$15.2 million for unbilled revenue receivables and \$101.9 million for billed utility services. Interest and other receivables as of January 31, 2006, included \$16.6 million for the receivables related to the JOA with Texas Genco, \$1.0 million for regulatory-related receivables, \$1.8 million for interest receivable and \$16.7 million for other miscellaneous receivables.

Payables – At January 31, 2007, accounts payable and accrued liabilities included \$209.8 million related to standard operating supplier and vendor payables, including fuels payable; \$35.9 million to employee-related payables; \$22.5 million to the current portion of lease-deferred revenue; \$3.7 million to Employee Benefit Plans; and \$42.8 million to other miscellaneous payables and accrued liabilities.

At January 31, 2006, accounts payable and accrued liabilities included \$152.6 million related to standard operating supplier and vendor payables, including fuels payable; \$41.4 million to employee-related payables; \$22.6 million to the current portion of lease-deferred revenue; \$4.8 million to Employee Benefit Plans; and \$34.8 million to other miscellaneous payables and accrued liabilities.

4. Capital Assets, Net

General Description – CPS Energy's plant-in-service includes seven power plants that are solely owned and operated by the Company. In total, the plants have 19 generating units—three of which are coal-fired and 16 of which are gas-fired. The following is a list of plants and relative generating units:

Plant	Generating Units	Type	Plant	Generating Units	Type
J.T. Deely	2	Coal	V.H. Braunig	3	Gas
J.K. Spruce	1	Coal	W.B. Tuttle	4 *	Gas
Arthur von Rosenberg	1	Gas	Leon Creek	6 *	Gas
O.W. Sommers	2	Gas			

*Included as a part of the 16 gas generating units are W.B. Tuttle Unit 2 and Leon Creek Unit 4, which are fully depreciated and are currently not available for use.

Construction on J.K. Spruce Unit 2 ("Spruce 2") was started on March 21, 2006, with plans for commercial operation in 2010. CPS Energy selected Calaveras Power Partners—a team led by Zachry Construction Corporation of San Antonio—to construct the 750-megawatt coal-fired generating unit at Calaveras Lake. Spruce 2 will be the largest of the coal units at Calaveras Lake, and it will be equipped with current emissions-control technology.

Plant-in-service also includes CPS Energy's 40% interest in STP. Other notable capital assets in electric and gas plant include a fleet of rail cars, a transmission network for the movement of electric power from the generating stations, and electric and gas distribution systems.

Included in general plant are the Energy Management Center; the main office complex; the North Side Customer Service Center; the construction and customer service centers; the Villita Assembly Building; and a fleet of automobiles, trucks and work equipment.

Impairments – An internal company-wide review of capital assets, in accordance with GASB Statement No. 42, indicated that CPS Energy had no impaired capital assets for FY 2007. Additionally, there were no impaired capital assets for FY 2006.

Investment in STP – STP is a two-unit nuclear power plant located in Matagorda County, Texas. It is maintained and operated by the STP Nuclear Operating Company (a nonprofit Texas corporation) and is financed and controlled by the owners—CPS Energy, NRG Energy, Inc. and the City of Austin. Also see Note 13 – South Texas Project.

To achieve the 40% interest in STP, CPS Energy exercised its right of first refusal to acquire an additional 12% (300 megawatts) share from a prior owner. The purchase was completed May 19, 2005, and increased CPS Energy's proportionate share of STP from 28% to 40%.

STP Capital Investment (40% share), Net

	January 31,	
	2007	2006
	(In thousands)	
STP capital assets (40% share), net		
Construction-in-progress	\$ 30,966	\$ 21,261
Land	5,701	5,701
Electric and general plant	1,376,023	1,417,016
Nuclear fuel	69,976	59,470
Total STP capital assets (40% share), net	<u>\$ 1,482,666</u>	<u>\$ 1,503,448</u>
Total CPS Energy assets, net	<u>\$ 5,294,792</u>	<u>\$ 4,942,636</u>
STP capital investment as a percentage of total CPS Energy capital assets, net	28.0%	30.4%

Capital Asset Rollforward – Below is a detail of the activity of CPS Energy's Net Capital Assets as presented on the Balance Sheets, including capital asset activity for the fiscal years ended January 31, 2007, and January 31, 2006:

FY 2007 Capital Asset Rollforward

(In thousands)

	Balance February 1, 2006	Additions/ Increases	Transfers In/ (Out)	(Reductions)/ (Decreases)	Balance January 31, 2007
Nondepreciable assets					
Land	\$ 58,651	\$ -	\$ 1,429	\$ -	\$ 60,080
Nonutility land	12,599	-	-	-	12,599
Construction-in-progress	296,946	546,009	(423,160)	-	419,795
Total nondepreciable assets	368,196	546,009	(421,731)	-	492,474
Depreciable assets					
Electric plant	6,259,022	36,801	335,897	(32,269)	6,599,451
Gas plant	574,138	3,827	22,201	1,287	601,453
General plant	540,008	13,625	63,633	(9,482)	607,784
Utility property leased	18,785	-	-	-	18,785
Nuclear fuel	485,055	36,174	-	-	521,229
Total depreciable assets	7,877,008	90,427	421,731	(40,464)	8,348,702
Accumulated depreciation, depletion and amortization					
Electric plant	(2,530,472)	(214,410)	-	36,407	(2,708,475)
Gas plant	(191,045)	(12,966)	-	(1,065)	(205,076)
General plant	(155,130)	(34,495)	-	8,885	(180,740)
Utility property leased	(336)	(504)	-	-	(840)
Nuclear fuel	(425,585)	(25,668)	-	-	(451,253)
Total accumulated depreciation, depletion and amortization	(3,302,568)	(288,043)	-	44,227	(3,546,384)
Capital assets, net	\$ 4,942,636	\$ 348,393	\$ -	\$ 3,763	\$ 5,294,792

Cash flow information – Cash paid for additions, net removal costs and nuclear fuel was \$623,739, and noncash AFUDC was \$16,460, for a total of \$640,199. Included in Reductions/Decreases was \$7,500 in removal costs, offset by \$3,737 in salvage sales. Depreciation and depletion totaled \$288,043.

Other – The increases in electric plant also included new substations and distribution infrastructure.

FY 2006 Capital Asset Rollforward

(In thousands)

	Balance February 1, 2005	Additions/ Increases	Transfers In/ (Out)	(Reductions)/ (Decreases)	Balance January 31, 2006
Nondepreciable assets					
Land	\$ 56,482	\$ 535	\$ 1,634	\$ -	\$ 58,651
Nonutility land	12,599	-	-	-	12,599
Construction-in-progress	180,594	335,977	(219,625)	-	296,946
Total nondepreciable assets	249,675	336,512	(217,991)	-	368,196
Depreciable assets					
Electric plant	5,977,120	167,447	167,787	(53,332)	6,259,022
Gas plant	496,470	2,664	30,210	44,794	574,138
General plant	531,810	8,745	19,994	(20,541)	540,008
Utility property leased	18,785	-	-	-	18,785
Nuclear fuel	319,186	45,636	120,233	-	485,055
Total depreciable assets	7,343,371	224,492	338,224	(29,079)	7,877,008
Accumulated depreciation, depletion and amortization					
Electric plant	(2,349,009)	(202,781)	-	21,318	(2,530,472)
Gas plant	(171,370)	(11,022)	-	(8,653)	(191,045)
General plant	(142,540)	(32,607)	-	20,017	(155,130)
Utility property leased	(336)	-	-	-	(336)
Nuclear fuel	(283,797)	(21,555)	(120,233)	-	(425,585)
Total accumulated depreciation, depletion and amortization	(2,947,052)	(267,965)	(120,233)	32,682	(3,302,568)
Capital assets, net	\$ 4,645,994	\$ 293,039	\$ -	\$ 3,603	\$ 4,942,636

Cash flow information – Cash paid for additions, net removal costs and nuclear fuel was \$559,938, and noncash AFUDC was \$4,669, for a total of \$564,607. Included in Reductions/Decreases was \$6,715 in removal costs, offset by \$3,112 in salvage sales. Depreciation and depletion totaled \$267,965.

Other – The \$120,233 under Transfers In/ (Out) represents the addition of nuclear fuel and its amortization as acquired through the additional 12% purchase of STP. The increases in electric plant also included the 12% STP acquisition, as well as new substations and distribution infrastructure. The STP acquisition is included in the electric plant Additions/Increases column. Included in electric plant was the Mission Road generation plant ("MRP") that had an acquisition value of \$12.5 million. MRP was taken out of service on October 1, 2003, after being fully depreciated.

5. Revenue Bond and Commercial Paper Ordinances Requirements

Senior Lien – As of January 31, 2007, the bond ordinances for New Series Bonds issued on and after February 1, 1994, contained, among others, the following provisions:

Revenue deposited in CPS Energy's General Account shall be pledged and appropriated to be used in the following priority for:

- Maintenance and operating expenses of the electric and gas systems ("Systems");
- Payments of the New Series Bonds;
- Payment of Prior Lien Bonds, including Junior Lien Obligations;
- Payment of the Notes and the Credit Agreement (as defined in the ordinance authorizing Commercial Paper);
- Payment of any Inferior Lien Obligations issued, which are inferior in lien to the New Series Bonds, the Prior Lien Bonds and the Notes and Credit Agreement;

- An annual amount equal to 6% of the gross revenue of the Systems to be deposited in the Repair and Replacement Account;
- Cash payments and benefits to the General Fund of the City not to exceed 14% of the gross revenue of the Systems; and
- Any remaining net revenues of the Systems in the General Account to the Repair and Replacement Account.

The maximum amount in cash to be transferred or credited to the City's General Fund from the net revenues of the Systems during any fiscal year shall not exceed 14% of the gross revenues of the Systems, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the fiscal year for additions to the street lighting system. The percentage of gross revenues of the Systems to be paid over, or credited to, the City's General Fund each fiscal year shall be determined (within the 14% limitation) by the governing body of the City.

The net revenues of the Systems are pledged to the payment of principal of and interest on the New Series Bonds, which are classified as Senior Lien Obligations. All New Series Bonds and the interest thereon shall have a first lien upon the net revenues of the Systems.

Junior Lien – The Junior Lien, Variable Rate Demand Obligation ("VRDO") bonds are debt instruments of the City payable solely from, and equally and ratably secured by, a junior lien on and pledge of the net revenues of the Systems, subject and subordinate to liens and pledges securing the outstanding Senior Lien Obligations and any additional Senior Lien Obligations hereafter issued, and superior to the pledge and lien securing the currently outstanding Commercial Paper Obligations, all as fully set forth in the ordinances authorizing the issuance of the Junior Lien Obligations as noted below:

The City agrees that it will at all times maintain rates and charges for the sale of electric energy, gas or other services furnished, provided and supplied by the Systems to the City and all other consumers, which shall be reasonable and nondiscriminatory and which will produce income and revenues sufficient to pay:

- All maintenance and operating expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502 of the Texas Government Code, as amended;
- The interest on, and principal of, all Parity Bonds, as defined in the New Series Bond Ordinances, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Parity Bonds;
- The interest on, and principal of, the Prior Lien Bonds, including the Junior Lien Obligations and any additional Junior Lien Obligations hereafter issued (all as defined in the New Series Bond Ordinances), as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Junior Lien Obligations and any additional Junior Lien Obligations;
- To the extent the same are reasonably anticipated to be paid with available revenues (as defined in the Ordinance authorizing the Commercial Paper), the interest on and principal of all Notes (as defined in said Ordinance), and the Credit Agreement (as defined in said Ordinance); and
- Any legal debt or obligation of the Systems as and when the same shall become due.

Tax-Exempt Commercial Paper ("TECP") – As of January 31, 2007, the TECP Ordinance contains, among others, the following provisions:

To secure the payment of TECP principal and interest, a pledge is made of:

- Proceeds from
 - The sale of bonds and additional notes issued for such purposes, and
 - The sale of TECP;
- Loans under and pursuant to the revolving credit agreement; and
- The net revenues of the Systems, after payment on New Series Bond requirements and Prior Lien Bond Obligations.

Compliance – As of January 31, 2007, and January 31, 2006, CPS Energy was in compliance with the terms of the New Series Bonds, the Junior Lien Obligations and the TECP Ordinances.

6. Revenue Bonds

On August 31, 2006, CPS Energy issued \$384.2 million of tax-exempt New Series 2006A Revenue Bonds. These bonds were partially used to reimburse the Repair and Replacement Account for construction expenditures made during the months of February through July 2006 in the amount of \$131.2 million. The \$268.8 million remaining proceeds and net original issue premium will be used to fund generation, as well as electric and gas distribution construction projects.

On August 11, 2006, \$106.4 million of New Series 1997 Revenue and Refunding Bonds were legally defeased with cash. Under this defeasance, the debt obligations have been technically voided, as an appropriate level of cash has been set aside in escrow to service the debt. As a result, an accounting loss of \$7.2 million was recorded. The basis of the loss calculation included \$107.8 million paid for the actual defeasance; less the par value of debt outstanding; plus unamortized bond issue, reacquisition and discount costs.

On October 27, 2005, CPS Energy issued \$197.3 million of tax-exempt New Series 2005A Bonds. The true interest cost of these bonds was 4.6%. CPS Energy received net proceeds of \$201.5 million from the issuance of these bonds. Of this amount, \$200.0 million was used to retire commercial paper, with the remaining used to pay costs and expenses relating to the issuance of the bonds. See Note 7 – Commercial Paper.

On April 13, 2005, CPS Energy issued \$535.3 million of tax-exempt New Series 2005 Bonds. Included were par amounts of \$294.6 million of Revenue Refunding Bonds and \$240.7 million of Revenue Bonds. The true interest cost of these bonds was 4.5%. CPS Energy received net proceeds of \$250.0 million from the issuance of the Revenue Bonds. Proceeds were used to fund transmission, electric distribution, information technology and communication, and general property construction. Refunding of higher cost outstanding bonds resulted in net present value debt service savings of \$19.7 million, or 6.7% of the par amount of the refunded bonds. This transaction resulted in a loss for accounting purposes of \$14.3 million, which has been deferred and is being amortized over the shorter life of either the refunded or refunding bonds.

Revenue Bond Summary

Maturities	Weighted-Average Yield on Outstanding Bonds at January 31, 2007	January 31,	
		2007	2006
(In thousands)			
Tax-exempt new series			
bonds 1994A–2006A, 2008–2025	4.8%	\$ 2,578,485	\$ 2,429,645
Taxable new series			
bonds 1998 & 2000, 2008–2021	6.7%	125,370	131,240
Total	4.8%	2,703,855	2,560,885
Tax-exempt variable rate series			
bonds 2003–2004, 2024–2033		407,000	407,000
Total long-term revenue bonds outstanding		3,110,855	2,967,885
Less: Current maturities of bonds		141,755	135,155
Total revenue bonds outstanding, net of current maturities		\$ 2,969,100	\$ 2,832,730

As of January 31, 2007, principal and interest amounts due for all revenue bonds outstanding for each of the next five years and thereafter to maturity are:

(In thousands)			
Year	Principal	Interest	Total
2008	\$ 141,755	\$ 152,493	\$ 294,248
2009	151,225	145,274	296,499
2010	148,170	137,495	285,665
2011	161,805	129,735	291,540
2012	175,900	121,216	297,116
2013-2017	722,290	473,450	1,195,740
2018-2022	717,340	300,127	1,017,467
2023-2027	603,120	121,159	724,279
2028-2032	239,250	39,188	278,438
2033	50,000	1,770	51,770
Totals	\$ 3,110,855	\$ 1,621,907	\$ 4,732,762

The above table includes Senior Lien and Junior Lien Bonds. Interest on the Senior Lien Bonds is based upon the stated coupon rates of each series of bonds outstanding. The 2003 Junior Lien Bonds were issued as variable-rate bonds and as such have interest rates that reset on a weekly basis. On December 1, 2005, the 2004 Junior Lien Bonds were remarketed for a two-year term at an interest rate of 3.6%. This interest rate will remain in effect until the next interest reset date of December 1, 2007. The total interest amounts for all revenue bonds outstanding included a blended interest rate of 3.5% for the 2003 and 2004 Junior Lien Bonds.

The interest rate term mode for the Junior Lien Revenue Bonds, or any portion thereof, may be converted to a different mode, or to an auction rate or term rate with an interest rate period of different duration, at the direction of the City. Following such a conversion, the Junior Lien Revenue Bonds, or portion thereof, will bear interest at the corresponding daily rate, weekly rate, auction rate, commercial paper rate, term rate or fixed rate.

FY 2007 Long-Term Debt Activity

(In thousands)	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-06	Additions During Year	(Decreases) During Year	Balance Outstanding 1-31-07
Revenue and refunding bonds							
1994A tax-exempt	\$ 684,700	2012	5.008	\$ 68,965	\$ -	\$ -	\$ 68,965
1995 tax-exempt	125,000	2007	5.500	5,800	-	(5,800)	-
1997 tax-exempt	350,000	2020	5.738	4,085	-	(4,085)	-
1997 tax-exempt	311,170	2014	5.509	102,355	-	(102,355)	-
1998A tax-exempt	785,515	2021	4.918	550,040	-	(34,545)	515,495
1998B taxable	99,615	2020	6.343	87,815	-	(4,175)	83,640
2000A tax-exempt	170,770	2010	5.374	11,170	-	(3,080)	8,090
2000B taxable	50,425	2021	7.403	43,425	-	(1,695)	41,730
2001 tax-exempt	115,280	2011	3.843	106,430	-	(21,400)	85,030
2002 tax-exempt	436,090	2017	4.055	436,090	-	-	436,090
2002 tax-exempt	140,615	2015	4.751	10,525	-	-	10,525
2003 tax-exempt – Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	89,150	-	(7,000)	82,150
2003 tax-exempt	350,490	2013	3.081	312,400	-	(57,080)	255,320
2004 tax-exempt – Junior Lien	160,000	2027	Variable	157,000	-	-	157,000
2005 tax-exempt	294,625	2020	4.381	294,625	-	-	294,625
2005 tax-exempt	240,675	2025	4.683	240,675	-	-	240,675
2005A tax-exempt	197,335	2025	4.571	197,335	-	-	197,335
2006A tax-exempt	384,185	2025	4.555	-	384,185	-	384,185
Bonds outstanding				2,967,885	384,185	(241,215)	3,110,855
Bond current maturities				(135,155)	(6,600)		(141,755)
Bond (discount) premium				102,164	18,447	(16,399)	104,212
Bond reacquisition costs				(121,298)	-	25,537	(95,761)
Revenue bonds, net				2,813,596	396,032	(232,077)	2,977,551
Tax-exempt commercial paper			Variable	150,000	200,000	-	350,000
Long-term debt, net				\$ 2,963,596	\$ 596,032	\$ (232,077)	\$ 3,327,551

FY 2006 Long-Term Debt Activity

(In thousands)	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-05	Additions During Year	(Decreases) During Year	Balance Outstanding 1-31-06
Revenue and refunding bonds							
1992 tax-exempt	\$ 700,805	2006	6.048	\$ 36,875	\$ -	\$ (36,875)	\$ -
1994A tax-exempt	684,700	2012	5.008	68,965	-	-	68,965
1994C tax-exempt	56,000	2006	5.008	42,710	-	(42,710)	-
1995 tax-exempt	125,000	2007	5.500	11,300	-	(5,500)	5,800
1997 tax-exempt	350,000	2020	5.738	169,715	-	(165,630)	4,085
1997 tax-exempt	311,170	2014	5.509	102,715	-	(360)	102,355
1998A tax-exempt	785,515	2021	4.918	582,965	-	(32,925)	550,040
1998B taxable	99,615	2020	6.343	89,870	-	(2,055)	87,815
2000A tax-exempt	170,770	2010	5.374	15,795	-	(4,625)	11,170
2000B taxable	50,425	2021	7.403	45,010	-	(1,585)	43,425
2001 tax-exempt	115,280	2011	3.843	106,430	-	-	106,430
2002 tax-exempt	436,090	2017	4.055	436,090	-	-	436,090
2002 tax-exempt	140,615	2020	4.751	140,615	-	(130,090)	10,525
2003 tax-exempt – Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	89,770	-	(620)	89,150
2003 tax-exempt	350,490	2013	3.081	312,400	-	-	312,400
2004 tax-exempt – Junior Lien	160,000	2027	Variable	160,000	-	(3,000)	157,000
2005 tax-exempt	294,625	2020	4.381	-	294,625	-	294,625
2005 tax-exempt	240,675	2025	4.683	-	240,675	-	240,675
2005A tax-exempt	197,335	2025	4.571	-	197,335	-	197,335
Bonds outstanding				2,661,225	732,635	(425,975)	2,967,885
Bond current maturities				(127,255)	(7,900)	-	(135,155)
Bond (discount) premium				89,149	34,438	(21,423)	102,164
Bond reacquisition costs				(134,227)	(9,714)	22,643	(121,298)
Revenue bonds, net				2,488,892	749,459	(424,755)	2,813,596
Tax-exempt commercial paper			Variable	350,000	-	(200,000)	150,000
Long-term debt, net				<u>\$ 2,838,892</u>	<u>\$ 749,459</u>	<u>\$ (624,755)</u>	<u>\$ 2,963,596</u>

On February 8, 2007, CPS Energy issued \$128.9 million of tax-exempt New Series 2006B Revenue Refunding Bonds. The true interest cost on these bonds was approximately 4.0%. On February 9, 2007, the bond proceeds were used to refund \$77.1 million par value of the taxable New Series 1998B Bonds and \$41.7 million par value of the taxable New Series 2000B Bonds. At that time, CPS Energy cash defeased \$6.5 million par value of the taxable New Series 1998B Bonds that could not be advance refunded with tax-exempt debt. The refunding transaction resulted in net present value debt service savings of \$6.7 million, or approximately 5.3% of the par amount of the bonds refunded.

7. Commercial Paper

In 1988, the City Council of San Antonio, Texas adopted an ordinance authorizing the issuance of up to \$300.0 million in TECP. This ordinance, as amended in June 1997, provides for funding to assist in the financing of eligible projects in an aggregate amount not to exceed \$450.0 million. Eligible projects include fuel acquisition, capital improvements to the utility systems, and refinancing or refunding any outstanding obligations, which are secured by and payable from a lien and/or a pledge of net revenues of the Systems. The program's scheduled maximum maturities cannot extend beyond November 1, 2028.

The TECP has been classified as long-term in accordance with the refinancing terms under a revolving credit agreement with a consortium of banks, which supports the commercial paper. Under the terms of the revolving credit agreement, CPS Energy may borrow up to an aggregate amount not to exceed

\$350.0 million for the purpose of paying principal due under the TECP. The revolving credit agreement is currently extended until November 1, 2010, and may be renewed for an additional year.

As of January 31, 2007, there have been no borrowings under the revolving credit agreement. The TECP is secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of existing New Series Bonds and Junior Lien Obligations.

CPS Energy issued \$200.0 million of TECP on August 24, 2006. These proceeds will be used to fund generation, as well as electric and gas distribution construction projects. The current outstanding TECP balance as of January 31, 2007, is \$350.0 million.

On October 27, 2005, CPS Energy issued \$197.3 million of New Series 2005A Revenue Refunding Bonds to redeem \$200.0 million of the outstanding TECP, as shown in Note 6 – Revenue Bonds. The TECP balance outstanding was \$150.0 million at January 31, 2006.

TECP Summary

(In thousands)	January 31,	
	2007	2006
TECP outstanding	\$ 350,000	\$ 150,000
TECP new money issues	200,000	-
Weighted-average interest rate of outstanding TECP	3.6%	3.1%
Average life of outstanding TECP (number of days)	90	96

8. Employee Pension Plan

The CPS Energy Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan ("Plan") covering substantially all employees who have completed one year of service. It is an unconsolidated entity within which normal retirement is age 65; however, early retirement is available with 25 years of benefit service, as well as to those employees who are ages 55 or older with at least ten years of benefit service.

Plan Participants Summary

	Plan (Calendar) Year Date - January 1,		
	2006	2005	2004
Retirees and beneficiaries currently receiving benefits	1,477	1,399	1,324
Terminated employees not yet receiving earned benefits	50	27	20
Current employees participating in Plan	3,779	3,902	3,926
Total	5,306	5,328	5,270

Retirement benefits are based on length of service and compensation, and benefits are reduced for retirement before age 55 with 25 years or more of benefit service or age 62 with less than 25 years of service. The Plan is sponsored by and may be amended by CPS Energy. Plan net assets, having a market value of \$1.1 billion at December 31, 2006; \$995.2 million at December 31, 2005; and \$978.6 million

at December 31, 2004, are held in a separate trust that is audited annually and in which statements include historical trend information. For further information, contact Compensation and Employee Benefits at CPS Energy.

The current policy of CPS Energy is to establish funding levels, considering annual actuarial evaluations and recommendations of the Administrative Committee, using both employee and employer contributions. Generally, participating employees contribute 5.0% of their total compensation and are normally fully vested in CPS Energy's contribution after completing seven years of credited service or at age 40.

Employee contributions commence with the effective date of participation and continue until attaining normal or early retirement age, completion of 44 years of benefit service or termination of employment. The balance of Plan contributions is the responsibility of CPS Energy, giving consideration to actuarial information, budget controls, legal requirements, compliance, and industry and/or community norms.

CPS Energy adopted a Restoration Plan effective January 1, 1998, to supplement benefits paid from the Plan due to federal tax restrictions on benefit amounts. The benefits due under the Restoration Plan have been paid annually by CPS Energy.

The total employer and employee pension funding, which includes amortization of past service costs using the unit credit cost actuarial method, is summarized as follows:

Pension Funding

(In thousands)	Fiscal Year Ended January 31,		
	2007	2006	2005
Employee contributions	\$ 10,005	\$ 9,570	\$ 9,215
Company contributions	9,626	7,131	8,160
Total contributions	<u>\$ 19,631</u>	<u>\$ 16,701</u>	<u>\$ 17,375</u>
Covered payroll	<u>\$ 210,074</u>	<u>\$ 198,441</u>	<u>\$ 189,892</u>
Total payroll	<u>\$ 221,456</u>	<u>\$ 206,800</u>	<u>\$ 198,648</u>

The pension plan assets are reported on a calendar-year basis; therefore, the actuarial tables are reported accordingly. The Pension Funding Progress and Pension Obligation tables below are not a required part of the basic financial statements but are required supplementary information (RSI) in accordance with U.S. generally accepted accounting principles.

The actuarially determined contribution requirements for calendar years 2007, 2006 and 2005 were computed using an assumed rate of return of 8.0%. The past service costs for 2007 and 2006 were amortized over a targeted 15 years versus a ten-year target for 2005. There were no changes in actuarial assumptions or in the actuarial cost method used for the 2007 valuation from those used for the 2006 valuation.

The employee contribution interest crediting rate was 8.0% for 2007. For 2006, it was reduced from 8.5% to 8.0%, with a negligible impact on actuarial valuation results. CPS Energy's company

contributions to the Plan amounted to 4.4% of covered payroll in FY 2007, 3.6% in FY 2006 and 4.3% in FY 2005.

Pension Funding Progress (RSI – Unaudited)

(In millions)	Plan (Calendar) Year Actuarial Valuation Date – January 1,					
	2006	2005	2004	2003	2002	2001
1. Actuarial value of assets	\$ 955.3	\$ 902.1	\$ 839.8	\$ 783.0	\$ 758.2	\$ 713.6
2. Actuarial accrued liability (AAL)	906.4	837.6	795.1	748.7	691.8	643.5
3. (Overfunded)/Unfunded AAL:						
(2) – (1)	\$ (48.9)	\$ (64.5)	\$ (44.7)	\$ (34.3)	\$ (66.4)	\$ (70.1)
4. Funded ratio (1) ÷ (2)	105.4%	107.7%	105.6%	104.6%	109.6%	110.9%
5. Covered payroll	\$ 210.1	\$ 198.4	\$ 189.9	\$ 186.7	\$ 180.3	\$ 165.3
6. (Overfunded)/Unfunded AAL as a percentage of covered payroll: (3) ÷ (5)	-23.3%	-32.5%	-23.5%	-18.4%	-36.8%	-42.4%

Actuarial valuation methods used for January 1, 2006, 2005 and 2004 included (a) the five-year smoothed market for asset valuation, (b) the projected unit credit for actuarial accrued liability, and (c) the level dollar open for amortization of pension service costs. The remaining amortization periods for January 1, 2006, 2005 and 2004 were 29.4 years, 24.4 years and 21.6 years, respectively, and were calculated using the level dollar open amortization method.

Significant actuarial assumptions used for the January 1, 2006, actuarial valuation included (a) a rate of return on the investment of present and future assets of 8.0%, (b) projected salary increases averaging 4.1%, and (c) post retirement cost-of-living increases of 1.8%. The projected salary increases included an inflation rate of 3.5%. CPS Energy's pension cost and net pension obligation for the fiscal years ended January 31, 2007, 2006 and 2005, were as follows:

Pension Obligation (RSI – Unaudited)

(In thousands)	Fiscal Year Ended January 31,		
	2007	2006	2005
Annual required contribution ("ARC")	\$ 10,051	\$ 7,162	\$ 8,694
Less company contributions in relation to ARC	10,051	7,162	8,694
Net pension obligation – end of year	\$ -	\$ -	\$ -
Percentage of ARC contributed	100%	100%	100%

Employees who retired prior to 1983 receive annuity payments from an insurance carrier, as well as some benefits directly from CPS Energy. The costs for the benefits directly received from CPS Energy were \$175.6 thousand, \$222.6 thousand and \$224.3 thousand for the fiscal years ended January 31, 2007, 2006 and 2005, respectively. These costs were recorded when paid.

See Note 13 – South Texas Project for information on the STP Pension Plan.

9. Employee and Other Postemployment Benefits

The following table represents total claims payable by CPS Energy to the three Employee Benefit Plans combined:

(In thousands)	Fiscal Year ended January 31,	
	2007	2006
Beginning claims payable	\$ 4,597	\$ 5,259
Payments	(36,506)	(38,741)
Incurred claims	35,357	38,079
Ending claims payable	\$ 3,448	\$ 4,597

Plan Description – CPS Energy provides certain health and life insurance benefits for employees. Additionally, most CPS Energy employees are also eligible for these benefits upon retirement from the Company. Assets of the plans are held in three separate, single-employer contributory plans:

- City Public Service of San Antonio Group Health Plan ("health plan")
- City Public Service of San Antonio Group Disability Plan ("disability plan")
- City Public Service of San Antonio Group Life Insurance Plan ("life plan")

The Employee Benefit Plans' assets are segregated from CPS Energy's assets. They are separately managed by a committee whose members are appointed by the CPS Energy General Manager and CEO. These plans report results on a calendar-year basis and issue separately audited financial statements that may be obtained by contacting Compensation and Employee Benefits at CPS Energy.

Basis of Accounting – The financial statements of each of the three Employee Benefit Plans are prepared using the accrual basis of accounting in conformity with U.S. GAAP. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plans apply all GASB pronouncements as well as FASB pronouncements, issued on or before November 30, 1989, unless those FASB pronouncements conflict with or contradict GASB pronouncements.

Funding – Funding of the plans is from both participant and employer contributions determined by annual actuarial and in-house calculations. Retired employees contribute to the health plan in varying amounts depending upon an equity formula that considers age and years of service. The plan may be amended by CPS Energy. The annual cost of retiree health and life insurance benefits funded by CPS Energy is recognized as an expense of CPS Energy as employer contributions are made to the programs. These retiree costs approximated \$7.0 million and \$5.7 million for the fiscal years ended January 31, 2007 and 2006, respectively. CPS Energy reimbursed a percentage of the monthly premium to certain retirees and their spouses enrolled in Medicare Part B. Costs for this reimbursement were \$451.5 thousand and \$413.8 thousand for the fiscal years ended January 31, 2007 and 2006, respectively.

Retired employees and covered dependents contributed \$3.2 million for their health and life insurance benefits in FY 2007 and \$2.5 million in FY 2006. In FY 2007, there were 2,502 retirees and covered dependents eligible for health and life insurance benefits, as compared to 2,473 in FY 2006.

The Medicare Prescription Drug Improvement and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D entitled the health plan to receive retiree drug subsidy

payments from the federal government to offset pharmacy claims paid by the health plan on behalf of certain plan participants. The plan began receiving subsidy payments in the third quarter of FY 2007; these payments totaled \$598.2 thousand as of January 31, 2007. In accordance with GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*, future projected payments from the federal government have not been used to lessen total projected obligations under the Company's plan.

Actuarial Valuation – In view of the potential economic significance of these benefits, CPS Energy has reviewed the present value of the postemployment benefit obligations for current retirees. The January 1 valuations were \$101.6 million for 2006 and \$104.5 million for 2005 for health benefits and \$27.0 million for 2006 and \$25.0 million for 2005 for life insurance benefits. The actuarial analysis of the present value of postemployment benefit obligations for all active employees is estimated to be \$126.8 million for health, \$33.9 million for life insurance and \$6.0 million for disability benefits. CPS Energy began partial accrual and funding of projected future benefits in 1992. Funding totaled \$3.2 million in FY 2007, \$4.2 million in FY 2006 and \$5.2 million in FY 2005.

For the health plan, the actuarial cost method used was the Projected Unit Credit Actuarial Cost Method. For the life insurance and disability plans, CPS Energy used a present-value method to determine the cost of benefits.

Significant actuarial assumptions used in the calculations for January 1, 2006, included (a) a rate of return on the investment of present and future assets of 8.0% for the health, life and disability plans, (b) projected salary increases for the plans ranging from 4.5% to 12.0% depending on age for base and other salaries, and (c) medical cost increases projected at 10.0% for 2006, decreasing to 5.5% in 2016 and thereafter.

Health Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
1/1/2004	\$109,486	\$199,076	\$ 89,590	55.0%	\$189,892	47.2%
1/1/2005	121,700	233,280	111,580	52.2%	198,441	56.2%
1/1/2006	133,851	228,446	94,595	58.6%	210,074	45.0%

*The actuarial accrued liability consisted of the liability for both retired employees and active employees. The actuarial accrued liability for retired employees was \$101.6 million for January 1, 2006; \$104.5 million for January 1, 2005; and \$80.5 million for January 1, 2004.

Disability Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date*	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
1/1/2006	\$4,109	\$6,000	\$ 1,891	68.5%	\$210,074	0.9%

*Per GASB Statement 43, the Actuarial Accrued Liability is not being reported for the Actuarial Valuation Dates of 1/1/2005 and 1/1/2004 since they were not calculated in accordance with this Statement.

Life Plan
Schedule of Funding Progress (RSI – Unaudited)
(In thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
1/1/2004	\$41,979	\$52,309	\$ 10,330	80.3%	\$189,892	5.4%
1/1/2005	44,174	58,021	13,847	76.1%	198,441	7.0%
1/1/2006	46,662	60,903	14,241	76.6%	210,074	6.8%

*The actuarial accrued liability consisted of the liability for both retired employees and active employees. The actuarial accrued liability for retired employees was \$27.0 million for January 1, 2006; \$25.0 million for January 1, 2005; and \$21.8 million for January 1, 2004.

10. Other Obligations and Risk Management

Other Liabilities & Deferred Credits – CPS Energy maintains other obligations as noted below. The relative long-term portion of these obligations compared to the total as of January 31, 2007, and January 31, 2006, was 97.8% and 97.7%, respectively.

FY 2007 Other Liabilities & Deferred Credits

	Rollforward				Total	
	Balance			Balance	Amounts	Long-Term
(In thousands)	Outstanding	Additions	(Decreases)	Outstanding	Due within	Balance
	2-1-2006	During Year	During Year	1-31-2007	One Year	Outstanding
Customer deposits	\$ 22,363	\$ 18,397	\$ (15,975)	\$ 24,785	\$ -	\$ 24,785
Decommissioning trusts	301,072	154,113	(7,028)	448,157	-	448,157
Deferred lease revenue (long-term)	588,454	-	(22,560)	565,894	22,561	543,333
	911,889	172,510	(45,563)	1,038,836	22,561	1,016,275
Other						
Insurance reserves	12,781	11,924	(12,294)	12,411	1,949	10,462
STP pension and other postemployment benefits	25,209	14,638	(10,145)	29,702	-	29,702
Project Warm	7,522	272	(107)	7,687	-	7,687
Notes payable	5,349	-	(374)	4,975	580	4,395
Customer advances	25,924	29,620	(24,681)	30,863	-	30,863
Deferred credits	17,186	72,979	(79,494)	10,671	-	10,671
Other	600	-	(37)	563	-	563
Total other liabilities	94,571	129,433	(127,132)	96,872	2,529	94,343
Total other long-term liabilities & deferred credits	\$ 1,006,460	\$ 301,943	\$ (172,695)	\$ 1,135,708	\$ 25,090	\$ 1,110,618

FY 2006 Other Liabilities & Deferred Credits

(In thousands)	Rollforward				Total	
	Balance			Balance	Amounts	Long-Term
	Outstanding 2-1-2005	Additions During Year	(Decreases) During Year	Outstanding 1-31-2006	Due within One Year	Balance Outstanding
Customer deposits	\$ 19,419	\$ 15,708	\$ (12,764)	\$ 22,363	\$ -	\$ 22,363
Decommissioning trusts	222,410	78,662	-	301,072	-	301,072
Deferred lease revenue (long-term)	611,015	-	(22,561)	588,454	22,561	565,893
	852,844	94,370	(35,325)	911,889	22,561	889,328
Other						
Insurance reserves	12,880	5,634	(5,733)	12,781	-	12,781
STP pension and other postemployment benefits	13,925	11,578	(294)	25,209	-	25,209
STP fuel assessment	655	280	(935)	-	-	-
Project Warm	7,583	601	(662)	7,522	-	7,522
Notes payable	5,800	-	(451)	5,349	460	4,889
Customer advances	23,793	23,463	(21,332)	25,924	-	25,924
Deferred credits	1,446	47,058	(31,318)	17,186	-	17,186
Other	598	21	(19)	600	-	600
Total other liabilities	66,680	88,635	(60,744)	94,571	460	94,111
Total other long-term liabilities & deferred credits	\$ 919,524	\$ 183,005	\$ (96,069)	\$ 1,006,460	\$ 23,021	\$ 983,439

Reserves – CPS Energy is exposed to various risks of loss including, but not limited to, those related to torts, theft or destruction of assets, errors and omissions, and natural disasters. CPS Energy maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major risks. The property insurance program provides \$4.3 billion of replacement-value coverage for property and boiler machinery loss, including comprehensive automobile coverage, fire damage coverage for construction equipment and valuable papers coverage. The deductible for the property insurance policy is \$5.0 million for general property and turbine generators/transformers. The liability insurance program includes:

- \$100.0 million of excess general liability coverage over a retention amount of \$2.0 million;
- \$25.0 million of fiduciary liability coverage; and
- Other property and liability insurance coverage, which includes employee travel, event insurance and commercial crime.

Actuarial studies are performed periodically to assess and determine the adequacy of insurance reserve retentions. An actuarial study was performed in the third quarter of FY 2007.

The remaining property reserve balance at January 31, 2007, related to estimated obligations for the cleanup, closure and post-closure care requirements of the Company's landfills. CPS Energy has seven landfill sites—four of which are at full capacity. The estimates for landfill liability are based upon capacity to date and are subject to change due to inflation or deflation, as well as new developments in technology, applicable laws or regulations.

CPS Energy also manages its own workers' compensation program. Additionally, to support this program, \$35.0 million of excess workers' compensation coverage over a retention amount of \$2.0 million is maintained.

Beginning in FY 2007, our reserve program was modified to record all claims against the reserve, whereas in prior years only significant claims were recorded against the reserve.

(In thousands)	Reserve Rollforward		
	Employee & Public Liability Claims	Property Reserves	Total Insurance Reserves
Balance – FY 2005	\$ 6,035	\$ 6,845	\$ 12,880
Payments	(341)	-	(341)
Incurring claims	-	-	-
Other claims adjustments	3,449	(3,208)	241
Balance – FY 2006	\$ 9,143	\$ 3,637	\$ 12,780
Payments	(2,590)	-	(2,590)
Incurring claims	-	-	-
Other claims adjustments	2,118	101	2,219
Balance – FY 2007	\$ 8,671	\$ 3,738	\$ 12,409

11. Other Financial Instruments

Hedging – The 1999 Texas utility deregulation legislation, Senate Bill 7, contained provisions modifying the PFIA to allow municipal utilities the ability to purchase and sell energy-related financial instruments in order to hedge or mitigate the effect of market price fluctuations of natural gas, fuel oil and electric energy.

On July 31, 2006, the CPS Energy Board of Trustees reaffirmed the Energy Price Risk Management Policy, which sets forth the guidelines for the purchase and sale of certain financial instruments and certain physical products, collectively defined as hedge instruments. The essential goal of the Energy Price Risk Management Policy is to provide a framework for the operation of a fuel and energy price hedging program to better manage CPS Energy's risk exposures in order to stabilize pricing and costs for the benefit of CPS Energy and its customers.

The hedge instruments are reported at cost on the Balance Sheet. Gains and losses related to the hedge instrument transactions are netted to fuel expense in the period realized. For FY 2007 and FY 2006, the commodity options and/or hedge instruments offset one another to achieve unrealized gains (losses) of approximately (\$892.8) thousand and \$240.4 thousand, respectively.

CPS Energy follows GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*.

Accordingly, the following information is provided regarding CPS Energy's outstanding financial hedge instruments as of January 31, 2007 and 2006:

Fuel Derivative Transactions as of January 31, 2007

Type of Transaction		Duration	Volumes in MMBtu
Long	Call	Dec 2007 through Mar 2008	6,310,000
Short	Call	Dec 2007 through Mar 2008	6,310,000
Short	Put	Dec 2007 through Mar 2008	6,310,000
Long	NG Futures	Mar 2007	50,000
Long	Basis Swap	Feb 2007 through Mar 2007	147,500

Fuel Derivative Transactions as of January 31, 2006

Type of Transaction		Duration	Volumes in MMBtu
Long	Call	Mar 2006 through Mar 2007	16,050,000
Short	Call	Mar 2006 through Mar 2007	16,580,000
Long	Put	Mar 2006 through Oct 2006	1,080,000
Short	Put	Mar 2006 through Mar 2007	16,050,000
Long	NG Futures	Mar 2006 through Oct 2006	530,000

The fair value of option contracts is determined using New York Mercantile Exchange ("NYMEX") closing settlement prices as of the last day of the reporting period. For futures and basis swap contracts, the fair value is calculated by deriving the difference between the closing futures prices on the last day of the reporting period and the futures or basis swap purchase prices at the time the positions were established, less applicable commissions. As of January 31, 2007, the total cost of the outstanding hedge instruments was \$30.7 thousand, with a fair value of (\$855.4) thousand. On January 31, 2006, total cost for outstanding hedge instruments was \$28.0 thousand, with a fair value of \$285.9 thousand.

In the event purchased options are allowed to expire, the related premiums paid to acquire those options will be lost. When a short position is established and options are sold, premiums are received and an obligation to honor the terms of the option contract, if exercised, is created. The decision to exercise the options or let them expire rests with the purchasing party.

Futures contracts represent a firm obligation to buy or sell the underlying asset. If held to expiration, the contract holder must take delivery of, or deliver, the underlying asset at the established contract price. Basis swap contracts represent a financial obligation to buy or sell the underlying delivery point basis. If held to expiration, the financial difference determined by mark-to-market valuation must be settled on a cash basis. Only if expressly requested in advance, may an exchange for physical assets take place.

The hedging contracts expose CPS Energy to a minimal amount of credit risk. In the event of default or nonperformance by brokers or NYMEX, the operations of CPS Energy could be materially affected. However, CPS Energy does not expect the brokerages to fail to meet their obligations given their high credit rating and the strict and deep credit requirements upheld by NYMEX, of which these brokerage houses are members. Termination risk for exchange-traded instruments is greatly reduced by the strict rules and guidelines established by NYMEX, which is governed by the Commodity Futures Trade Commission.

Securities Lending – CPS Energy, the 28% Decommissioning Trust and the 12% Decommissioning Trust began engaging in securities lending transactions in FY 2007 under a contract with their lending agent, Frost National Bank. Authority to engage in these transactions is granted under each entity's Investment Policy. Prior to January 31, 2007, the entities were authorized to loan up to 75.0% of their investments in securities lending transactions. The Investment Policies were revised effective January 31, 2007, authorizing up to 100.0% of investments to be loaned.

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending transactions. This guidance includes reporting certain securities lending collateral on the Balance Sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

In securities lending transactions, CPS Energy and the Decommissioning Trusts, through their lending agent, transfer securities to brokers/dealers in exchange for collateral and simultaneously agree to return the collateral for the same securities in the future. Cash collateral received from the borrower is invested in AAA-rated money market mutual funds. The maturities of these investments do not necessarily match the term of the loans, rather the investments are managed to maintain an average maturity of 30 days.

Lending income is earned if the returns on the cash collateral invested exceed the rebate paid to borrowers of the securities. The income is then shared with the lending agent to cover its fees based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from CPS Energy's or the Decommissioning Trusts' resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a loan premium for the securities loaned. This income is split at the same ratio as the earnings for cash collateral. The collateral pledged to CPS Energy or the Decommissioning Trusts for the loaned securities is held by the lending agent. These securities are not available to the Company or the Decommissioning Trusts for selling or pledging unless the borrower is in default of the loan.

Any collateral received is required to have a fair value of 102.0% of the loaned securities. Securities are marked to market daily, and additional cash or securities are required from the borrower if the market value of the collateral falls below 100.0%. Cash collateral is reported on the Balance Sheet as an asset, with a corresponding liability for the obligation. Noncash collateral for securities lending activities is not recorded as an asset because it remains under the control of the transferor, except in the event of default.

In the event of default, where the borrower is unable to return the securities loaned, CPS Energy and the Trusts have authorized the lending agent to seize the collateral held. The collateral would then be used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities may not be able to be replaced. The lending agent has indemnified CPS Energy and the Decommissioning Trusts from any loss due to borrower default in the event the collateral is not sufficient to replace the securities.

At year-end, neither CPS Energy nor the Decommissioning Trusts had any credit risk exposure to borrowers because the amounts the Company and/or the Trusts owed to borrowers exceeded the amounts the borrowers owed. There were no violations of legal or contractual provisions nor were there any borrower or lending agent default losses.

CPS Energy Direct Investments

At January 31, 2007, there was a total of \$779.6 million in securities, or 65.5% of the Company's direct investments, out on loan to brokers/dealers. In exchange, the Company received \$626.4 million in cash collateral and \$165.9 million in securities collateral, or 101.6% of the market value of the corresponding securities loaned. Income generated from securities lending transactions amounted to \$294.8 thousand in FY 2007, of which 30% was paid as fees to the lending agent totaling \$88.4 thousand.

Decommissioning Trusts

For the 28% Decommissioning Trust at December 31, 2006, there was a total of \$75.6 million in securities, or 29.7% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$75.2 million in cash collateral and \$2.8 million in securities collateral, or a total of 103.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$58.4 thousand in calendar year 2006, of which 30% was paid as fees to the lending agent totaling \$17.5 thousand.

For the 12% Decommissioning Trust at December 31, 2006, there was a total of \$36.2 million in securities, or 44.0% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Decommissioning Trust received \$34.8 million in cash collateral and \$2.5 million in securities collateral, or a total of 103.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$15.9 thousand in calendar year 2006, of which 30% was paid as fees to the lending agent totaling \$4.7 thousand.

12. Lease/Leaseback

In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon involving CPS Energy's Spruce 1 coal-fired electric generation unit. The transaction included a lease for a term of approximately 65 years in combination with a leaseback of the facility by CPS Energy for approximately 33 years.

CPS Energy retains fee simple title to, and operating control of, the facility and retains all revenues generated from sales of electricity produced from the facility. CPS Energy received the appraised fair value of the unit, \$725.0 million. This amount was recorded as deferred revenue, net of transaction expenses, and is being amortized over 381 months. The leaseback costs of \$628.3 million were recorded as prepaid items in 2001 and are being amortized over 381 months.

CPS Energy has the option to cancel the lease after it expires by making a payment to Exelon's affiliate. CPS Energy entered into a collateralized payment-undertaking agreement that will generate amounts sufficient to fund the cancellation option.

CPS Energy's net benefits associated with the transaction were approximately \$88.0 million. The City was paid \$12.3 million in accordance with the provisions of the New Series Bond Ordinance that permit 14% of this net benefit to be distributed. That distribution was recorded as a prepayment in the fiscal year ended January 31, 2001 and is being amortized over 381 months, or approximately 32 years. As a result, net proceeds from the transaction of approximately \$75.7 million are being reported over the 32-year leaseback term. In both FY 2007 and FY 2006, the net amount recorded as income by CPS Energy was \$2.8 million for each period.

13. South Texas Project

CPS Energy is one of three participants in STP, a two-unit nuclear power plant with Unit 1 nominally rated to produce 1,354.25 megawatts and Unit 2 nominally rated to produce 1,281.25 megawatts. The units, along with their support facilities and administrative offices, are located on a 12,220-acre site in Matagorda County, Texas. In-service dates for STP were August 1988 for Unit 1 and June 1989 for Unit 2. The other participants in STP are NRG Energy, Inc. and the City of Austin. Increased by the additional 12% interest acquired in FY 2006, CPS Energy's 40% ownership in STP represents 1,054.2 megawatts of total plant capacity. On February 2, 2006, NRG Energy, Inc. acquired one of the prior participants of STP, Texas Genco. See Note 4 – Capital Assets, Net for more information about CPS Energy's capital investment in STP.

New Units – On June 28, 2006, NRG Energy, Inc. announced plans to construct two additional reactors at the currently functioning STP site. With this addition, energy production is expected to increase by 2,700 megawatts for a total STP production capacity of 5,335.5 megawatts. NRG Energy, Inc. filed a letter of intent with the Nuclear Regulatory Commission ("NRC") on June 19, 2006, and will proceed with the permitting and development of the new units. CPS Energy, as co-owner, has an option to also participate in this new construction project and is currently conducting its own feasibility study to determine which course of action is in the best long-term interest of its customers. The costs associated with the feasibility study will be accumulated in a deferred account during the evaluation process. As of January 31, 2007, \$765.5 thousand have been spent on the feasibility study.

Effective November 17, 1997, the Participation Agreement among the owners of STP was amended and restated. At that time, the STP Nuclear Operating Company ("STPNOC"), a Texas nonprofit, nonmember corporation created by the participants, assumed responsibility as the licensed operator of STP. As of January 31, 2007, the agreement had not been amended. The participants share costs in proportion to ownership interests, including all liabilities and expenses of STPNOC.

CPS Energy amortizes its share of nuclear fuel for STP to fuel expense on a units-of-production method. Under the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the permanent disposal of spent nuclear fuel. CPS Energy is charged a fee for disposal of spent nuclear fuel, which is based upon CPS Energy's share of STP generation that is available for sale to CPS Energy customers. This charge is included in fuel expense monthly.

Nuclear Insurance – The Price-Anderson Act is a comprehensive statutory arrangement for providing limitations on liability and governmental indemnities with respect to nuclear accidents or events. The maximum amount that each licensee may be assessed following a nuclear incident at any insured facility is \$100.6 million, subject to adjustment for inflation, for the number of operating nuclear units and for each licensed reactor, payable at \$10.0 million per year per reactor for each nuclear incident. CPS Energy and each of the other participants of STP are subject to such assessments, which will be borne on the basis of their respective ownership interests. For purposes of these assessments, STP has two licensed reactors. The participants have purchased the maximum limits of nuclear liability insurance, as required by law, and have executed indemnification agreements with the NRC in accordance with the financial protection requirements of the Price-Anderson Act. A Master Worker Nuclear Liability policy, with a maximum limit of \$300.0 million for the nuclear industry as a whole, provides protection from nuclear-related claims.

NRC regulations require licensees of nuclear power plants to obtain on-site property damage insurance in a minimum amount of approximately \$1.1 billion. NRC regulations also require that the proceeds from this insurance be used first to ensure that the licensed reactor is in a safe and stable condition so as to prevent any significant risk to the public health or safety, and then to complete any decontamination operations that may be ordered by the NRC. Any funds remaining would then be available for covering direct losses to property.

The owners of STP currently maintain approximately \$2.8 billion of nuclear property insurance, which is above the legally required amount of \$1.1 billion, but is less than the total amount available for such losses. The \$2.8 billion of nuclear property insurance consists of \$500.0 million in primary property damage insurance and approximately \$2.3 billion of excess property damage insurance, both subject to a retrospective assessment being paid by all members of Nuclear Electric Insurance Limited ("NEIL"). A retrospective assessment could occur if property losses, as a result of an accident at any nuclear plant insured by NEIL, exceed the accumulated funds available to NEIL. The maximum aggregate assessment under current policies for both primary and excess property damage insurance is \$25.5 million during any one policy year.

Nuclear Decommissioning – CPS Energy, together with the other owners of STP, files a certificate of financial assurance with the NRC for the decommissioning of the nuclear power plant. The certificate assures that CPS Energy and the other owners meet the minimum decommissioning funding requirements mandated by the NRC.

The STP owners agreed in the financial assurance plan that their estimate of decommissioning costs would be reviewed and updated periodically. In 1999, the owners conducted a review of decommissioning costs. The results estimated CPS Energy's share of decommissioning costs at approximately \$311.0 million in 1998 dollars. In 2004, the owners conducted an additional review of decommissioning, and results showed that CPS Energy's share of decommissioning costs was approximately \$397.4 million in 2004 dollars. Although there was an increase in decommissioning base costs from the 1998 study to the 2004 study, there was an offsetting decrease in applicable cost escalation assumptions. Therefore, CPS Energy was able to decrease its minimum annual contribution requirement from \$15.9 million in FY 2004 to \$6.9 million in FY 2005, which included the partial-year effect of the updated study. Reflecting a full year's impact of the most recent study, CPS Energy's minimum annual contribution requirement was \$5.0 million in FY 2006 and remained at \$5.0 million for FY 2007.

In 1991, CPS Energy started accumulating the decommissioning funds for the 28% portion in an external trust in accordance with the NRC regulations. The 28% Decommissioning Trust's assets and related liabilities are included in CPS Energy's financial statements as a component unit. Excluding securities lending cash collateral, as of December 31, 2006 and 2005, CPS Energy had accumulated approximately \$256.2 million and \$231.6 million, respectively, in that 28% external trust. Based on the most recent annual calculation of financial assurance required by the NRC, CPS Energy's 28% Decommissioning Trust balance exceeded the calculated financial assurance amounts of \$87.3 million at December 31, 2006, and \$76.7 million at December 31, 2005.

In conjunction with the acquisition of the additional 12% interest in STP in May 2005, CPS Energy also assumed control of a relative portion of the decommissioning trust previously established by the prior owner, AEP. This is referred to as the 12% Decommissioning Trust, and its assets and related liabilities are also included in CPS Energy's financial statements as a component unit.

Subject to PUCT approval as requested in the future, credits or deficiencies in the funding of this trust will be received from or distributed to AEP customers. Excluding securities lending cash collateral, as of December 31, 2006 and 2005, that trust had accumulated approximately \$82.7 million and \$70.1 million, respectively. According to the 2004 study mentioned above, the estimated decommissioning costs for that trust are approximately \$170.3 million in 2004 dollars. Based on the most recent annual calculation of financial assurance required by the NRC, the 12% Decommissioning Trust balance exceeded the calculated financial assurance amount of \$37.4 million at December 31, 2006, and \$32.9 million at December 31, 2005.

Both Decommissioning Trusts also have separate calendar-year financial statements. These separately audited financial statements can be obtained by contacting the Controller at CPS Energy.

STP Pension Plan and Other Postretirement Benefits – STP maintains a noncontributory defined-benefit pension plan covering most employees. Retirement benefits are based on length of service and compensation. Plan assets are invested in various equity and fixed-income securities. No company contributions were made during the 2005 calendar year. Pension contributions in the amount of \$9.9 million were made by STP in the 2006 calendar year, of which \$7.9 million were for the 2005 plan year. Included in the STP pension liability for calendar years 2006 and 2005 is an additional minimum pension liability, which has been recognized as required due to the Plan's funding status, of \$18.8 million and \$15.1 million, respectively.

Employees whose pension benefits exceed \$220.0 thousand for Employee Retirement Income Security Act limitations are covered by a supplementary nonqualified, unfunded pension plan, which is provided for by charges to operations sufficient to meet the projected benefit obligation. The accruals for the cost of that plan are based on substantially the same actuarial methods and economics as the noncontributory defined-benefit pension plan.

STP also maintains a defined-benefit postretirement plan that provides medical, dental and life insurance benefits for substantially all retirees and eligible dependents. The cost of these benefits is recognized in the project statements during an employee's active working career. STP has a trust to partially meet the obligations of the plan.

The owners of STP, including CPS Energy, share in all plan costs in the same proportion as their respective ownership percentages.

STP Pension Plan
Schedule of Funding Status (RSI – Unaudited)
Calendar Years 2006 and 2005
(In thousands)

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Change in benefit obligation				
Benefit obligation – beginning	\$ 153,187	\$ 131,159	\$ 58,866	\$ 58,770
Service cost	7,498	6,164	4,332	3,973
Interest cost	9,101	7,813	3,299	3,048
Amendments	8,454	-	(2,884)	(13,470)
Actuarial loss	2,021	9,972	(8,194)	9,021
Benefits paid	(2,061)	(1,921)	(2,233)	(2,476)
Benefit obligation – ending	<u>178,200</u>	<u>153,187</u>	<u>53,186</u>	<u>58,866</u>
Change in plan assets				
Fair value of plan assets – beginning	100,808	89,989	9,975	9,752
Actual return on plan assets	9,070	12,740	451	790
Employer contributions	9,869	-	2,233	1,909
Benefits paid	(2,061)	(1,921)	(2,233)	(2,476)
Fair value of plan assets – ending	<u>117,686</u>	<u>100,808</u>	<u>10,426</u>	<u>9,975</u>
Funded status – ending	(60,514)	(52,379)	(42,760)	(48,891)
Unrecognized net actuarial loss	32,954	32,994	23,419	33,426
Unrecognized prior service cost	10,557	3,053	(16,656)	(14,958)
Unrecognized transition obligation	-	-	431	486
Net amount recognized	(17,003)	(16,332)	(35,566)	(29,937)
Additional minimum pension liability	(18,839)	(15,098)	-	-
Accrued benefit cost	<u>\$ (35,842)</u>	<u>\$ (31,430)</u>	<u>\$ (35,566)</u>	<u>\$ (29,937)</u>
Weighted-average assumptions				
Discount rate	5.75%	5.75%	5.80%	5.75%
Expected return on plan assets	8.50%	8.50%	8.50%	8.50%
Rate of compensation increase	3.00%	3.00%	3.00%	3.00%

14. Lignite Mining Lease and Assignment Agreement

CPS Energy entered into a lignite mining lease with Aluminum Company of America ("Alcoa") effective December 28, 1998, covering all of CPS Energy's lignite reserves in Bastrop and Lee Counties of Texas. Alcoa began making advance royalty payments to CPS Energy under the lease in January 1999. This converted to a production royalty when mining began in July 2005. All advance royalties previously received by CPS Energy are being deducted from production royalties at the same rate at which they were paid. The CPS Energy royalty falls within industry standard terms and is based on production volumes subject to certain minimum annual amounts. The base term of the lease runs through 2013. Renewal and extension options could result in Alcoa extending the lease to 2043.

On April 13, 2007 CPS Energy signed a Purchase and Sale Contract with a third party for the sale of the lignite properties.

15. Joint Operations Agreement

A 1997 Joint Operations Agreement ("JOA") resulted from the litigation settlement with a predecessor of Texas Genco II, L.P. ("Texas Genco") over its management of STP during the construction and early operating periods. The JOA was an arrangement to jointly dispatch CPS Energy's and Texas Genco's generating plants—other than STP—to take advantage of the most efficient plants and favorable fuel prices of each utility. Until June 2002, CPS Energy received 90.0% of the savings realized from the jointly operated systems in monthly cash payments. As of June 2002, when Texas Genco met the JOA \$200.0 million cumulative savings obligation, monthly cash payments to CPS Energy were reduced to 50.0% of the savings realized. As of January 24, 2006, CPS Energy's total cumulative payments from savings realized were \$310.4 million. Due to changes in market conditions and the ERCOT market structure, Texas Genco terminated the agreement as of January 24, 2006. On January 25, 2006, CPS Energy began directly representing its generation and load in the Texas energy market place.

16. Commitments and Contingencies

Purchase and construction commitments approximated \$2.3 billion at January 31, 2007. This amount includes provisions for natural gas purchases expected through June 2010; the actual amount to be paid will depend upon CPS Energy's actual requirements during the contract period and the price of gas. Also included are provisions for coal purchases through December 2021 and for coal transportation through December 2014.

CPS Energy also has other purchase commitments totaling \$1.6 billion. This amount includes provisions for wind power through December 2027, landfill power through December 2020, capacity and other power purchases through December 2009, and raw uranium associated with STP fabrication and conversion services needed for refueling through May 2026.

The PUCT promulgated new rules in 1996 designed to comply with legislative changes affecting the utility industry. The Transmission Pricing and Access Rule mandates that electric utilities charge customers for wholesale open transmission access according to a formula based on the amount of load served by each utility. Reported costs are based on payments to other transmission providers, less receipts for wholesale transmission services that CPS Energy provided. CPS Energy's cost for calendar years 2006 and 2005 was approximately \$18.5 million and \$15.1 million, respectively. CPS Energy has not calculated its cost for calendar year 2007.

In the fiscal year ended January 31, 2003, CPS Energy entered into a 20-year agreement with Brooks Development Authority ("BDA") to upgrade the electric and gas utility systems located within the Brooks City-Base. CPS Energy and BDA have each committed to invest \$6.3 million (\$4.2 million in year 2002 dollars, which accumulates interest at the rate of 3.7% compounded annually) to upgrade the infrastructure at that location. Annual reductions to BDA's obligation are made from incremental revenues to the City for electric and gas sales made to customers that reside on the BDA-developed property. Annual reductions to BDA's obligation are also made in accordance with contract terms for economic development at the Brooks City-Base that benefits CPS Energy's electric and gas systems. BDA's obligation is backed by the City.

To the extent that the capital renewals and upgrades do not total \$12.6 million by September 2022, BDA's and CPS Energy's obligations each will be reduced equally. To date, CPS Energy has invested \$3.7 million and BDA has reduced its obligation, net of annual interest, by \$0.8 million.

The Tax Increase Prevention and Reconciliation Act of 2005 enacted on May 17, 2006, added section 4965 to the Code ("Section 4965"), which imposes an excise tax with respect to "prohibited tax shelter transactions" on certain "tax-exempt entities," including a state or political subdivision thereof, such as

the City. CPS Energy, acting for the benefit of the City, entered into a series of leasing transactions in 2000, which may be considered prohibited tax shelter transactions.

Although the scope and applicability of Section 4965 is not clear, under one possible reading the IRS could assert that CPS Energy would be subject to the excise tax on a basis similar to a taxable entity. Accordingly, the City could be liable for an excise tax at the highest corporate tax rate (currently 35.0%) upon the greater of its net income for the taxable year properly attributable to the leasing transactions or 75.0% of the proceeds received by the City for the taxable year attributable to the leasing transactions. There are also additional excise tax provisions relating to "entity managers" (generally, persons with responsibility within the tax-exempt entity) and for certain "knowing" transactions, in which the tax-exempt entity knew or had reason to know that it was entering into a prohibited tax shelter transaction. In general, the new excise tax is effective for taxable years ending after the date of enactment of Section 4965.

CPS Energy has not been able to definitively determine the amount, if any, of the potential excise taxes it would be responsible for under Section 4965. However, the excise taxes under one scenario could exceed \$12.0 million for the taxable year ending in 2007. CPS Energy has not attempted to make any calculations for later taxable years. It is possible under some interpretations of Section 4965 that CPS Energy would not owe any excise taxes with respect to the leasing transactions.

In the normal course of business, CPS Energy is involved in legal proceedings related to alleged personal and property damages, breach of contract, condemnation appeals and discrimination cases. In addition, CPS Energy's power generation activities and other utility operations are subject to extensive state and federal environmental regulation. In the opinion of CPS Energy's management, the outcome of such proceedings will not have a material adverse effect on the financial position or results of operations of CPS Energy.

GLOSSARY OF TERMS

Advance Refunding: A bond issuance in which new bonds are sold at a lower interest rate than outstanding ones. The proceeds are then invested in an irrevocable escrow; and when the older bonds become callable, they are paid off with the invested proceeds.

Allowance for Funds Used During Construction ("AFUDC"): A cost accounting procedure whereby interest, charges on borrowed funds and a return on equity capital used to finance construction are added to utility plant being constructed (i.e., capitalized interest).

Amortize: To reduce an original amount or an account balance on an installment basis. Depreciation is a specific type of amortization.

Assets: Resources of value to the firm to which it has exclusive rights of use.

Balance Sheet: A statement of financial position as of a specific date, listing assets, liabilities and owner's equity.

Call: An option contract giving the owner the right (but not the obligation) to buy a specified amount of an underlying security at a specified price within a specified time.

Capital ("capital assets"): An asset with a life of more than one year that is not bought and sold in the ordinary course of business.

Cash and Cash Equivalents: The value of assets that can be converted into cash immediately. Usually includes bank accounts and marketable securities, such as government bonds. Cash equivalents on Balance Sheets include securities (e.g., notes) with an original maturity of 90 days or less.

Community Infrastructure and Economic Development ("CIED"): CIED funds are used to support qualified capital projects that provide economic benefit within the communities served by CPS Energy.

Component Unit: A legally separate entity for which the elected officials of the primary government are financially accountable and for which the nature and significance of its relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Cooling-Degree Day: This measures how high the average daily temperature is relative to a reference temperature of 72 degrees Fahrenheit. Example: If the average temperature for the day is 78 degrees, then the Cooling-Degree Days are equal to six.

Decommissioning: The process related to permanently taking a nuclear plant out of service, including decontaminating and removing buildings or other structures. Cleanup is concerned with ground remediation of contaminated land.

Defeasance: A provision that legally discharges a borrower for debt incurred when the borrower sets aside cash or bonds sufficient to service the debt outstanding.

Depletion: The systematic allocation of the cost of a natural resource from the balance sheet to the income statement.

Depreciation: Amount allocated during the period to expense the cost of acquiring long-term assets over the useful life of the assets.

Derivative: In finance, a security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Examples of derivatives include futures and options.

Electric Reliability Council of Texas ("ERCOT"): An organization whose mission is to direct and ensure reliable and cost-effective operation of the electric transmission grid in Texas and to enable fair and efficient market-driven solutions to meet customers' electric service needs.

Fair Market Value: The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federal Energy Regulatory Commission ("FERC"): Independent federal agency created within the U.S. Department of Energy. FERC is vested with broad regulatory authority over wholesale electric, natural gas and oil production and the licensing of hydroelectric facilities.

Fiscal Year ("FY"): The 12-month period covered by the income statement. A fiscal year may or may not coincide with a calendar year. For CPS Energy, the fiscal year is from February 1 through January 31. Accordingly, the quarter-ends are April 30, July 31, October 31 and January 31.

Futures: A financial contract obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange.

Governmental Accounting Standards Board ("GASB"): The authoritative standard-setting body for accounting and financial reporting for governmental entities in the United States.

Heating-Degree Day: This measures how low the average daily temperature is relative to a reference temperature of 65 degrees Fahrenheit. Example: If the average temperature for the day is 60 degrees, then the Heating-Degree Days are equal to 5.

Hedging: The process of buying and selling fuel oil, natural gas, and electric energy futures, options or similar contracts to protect against loss due to price fluctuations.

Kilowatt ("kW"): A measure of electric power. A kilowatt equals 1,000 watts. It produces enough energy to light up ten 100-watt light bulbs.

Kilowatt-hour ("kWh"): A measure of electric power. A kilowatt hour equals 1,000 watts of energy flowing for a one-hour period.

Lease: A legal agreement to pay rent to the lessor for a stated period of time. Sometimes the lease is in substance a purchase of an asset and a financing arrangement, i.e., capital lease.

Lease/Leaseback: A financing transaction that involves a company leasing an asset to another entity and that entity subleasing the asset back to the company.

Liabilities: Claims by creditors against the assets of the firm.

MCF: 1,000 cubic feet. Measures natural gas volumes.

MMBtu: 1,000,000 British Thermal Units ("BTU"). A BTU is the standard unit for measuring the quantity of heat energy, such as the heat content of fuel. It is the amount of heat energy necessary to raise the temperature of one pound of water one degree Fahrenheit at sea level pressure.

Management's Discussion & Analysis ("MD&A"): A section of the annual report that contains objective and easily readable analysis from management about the company's financial condition and its operations to assist users in assessing the company's financial position.

Megawatt ("MW"): A measure of electric power. A megawatt equals 1,000 kilowatts or 1,000,000 watts.

Megawatt-hour ("MWh"): Basic electric energy unit equal to one megawatt of power flowing for one hour.

National Association of Regulatory Utility Commissioners ("NARUC"): A nonprofit organization whose members include the governmental agencies that are engaged in the regulation of utilities and carriers in the 50 United States, the District of Columbia, Puerto Rico and the Virgin Islands. NARUC's member agencies regulate the activities of telecommunications, energy, and water utilities.

New Series Bonds: A CPS Energy term used to distinguish bonds that have a first lien on the net revenues of CPS Energy's systems.

Public Utility Commission of Texas ("PUCT"): The governmental commission that regulates the rates and services of telephone utilities; investor-owned electric, water and sewer utilities; electric, water and sewer utilities in unincorporated areas; and radio companies statewide. The PUCT does not have authority to regulate retail activities of municipally owned utilities.

Put: An option contract giving the owner the right (but not the obligation) to sell a specified amount of an underlying asset at a set price within a specified time.

Qualified Scheduling Entity ("QSE"): Entities that are qualified by ERCOT to submit balanced schedules, bid for ancillary services and settle payments. QSEs submit schedules on behalf of resource entities such as energy generators or load-serving entities such as retail electric providers.

Refunding: Retiring an outstanding bond issue after the first call date by using money from the sale of a new offering.

Required Supplementary Information (RSI): Schedules, statistical data and other information that are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity.

Revenue Bonds: Bonds issued by a municipality in which the issuer pledges to the bondholders its revenues as security for the bonds.

Securities Lending: An investment strategy that involves the temporary loan of securities to another party, typically dealers. For the full time that the securities are out on loan, they are secured with cash collateral in excess of the value of the securities that are lent, and in return for the use of securities, the lender earns a spread on the cash pledged as collateral.

South Texas Project ("STP"): A two-unit nuclear plant and is one of the newest and largest nuclear power plants in the country. STP's two reactors have a capacity of 2,562.5 megawatts of electricity, enough to provide service for more than one million homes and businesses in South Central Texas.

Tax-Exempt Bond: A bond usually issued by municipal, county, or state government whose interest payments are not subject to the bondholders' federal income tax and, in some cases, state and local income tax.

Tax-Exempt Commercial Paper ("TECP"): A short-term note with a maximum maturity of 270 days whose interest payments are not subject to the bondholders' federal income tax and, in some cases, state and local income tax. Maturities for TECP notes, however, can be extended indefinitely for the life of the program that supports the TECP notes.

Transmission Costs of Service ("TCOS"): A functional classification of expenses and capital expenditures relating to the operation and maintenance of the transmission plant. The transmission function is that portion of the utility system used for the purpose of transmitting electrical energy in bulk to other principal parts of the system or to other utility systems.

Variable Rate Demand Obligation ("VRDO"): A long-term bond with a floating interest rate that varies as it is re-determined periodically (daily, weekly, semi-annually, annually, etc.).

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MUNICIPALLY OWNED ELECTRIC & GAS UTILITY
SAN ANTONIO, TEXAS 2007