Late Backup

YOUR ELECTRIC RATES

Mission: *Deliver clean, affordable, reliable energy and excellent customer service.*

Reserves and Financial Policies
City Council Work Session
January 31, 2012

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Reserves Consistent with Other Public Power

Utility	Annual Revenue	Reserve Funds
Austin Energy (AE)	$ 1,145,071,164	$ 352,716,000
Los Angeles Department of Water & Power (LADWP)	$ 3,125,957,000	$ 561,414,000
Nebraska Public Power District (NPPD)	$ 998,000,000	$ 293,900,000
Jacksonville Electric Authority (JEA)	$1,684,131,000	$ 287,375,000
Municipal Electric Authority of Georgia (MEAG)	$ 741,799,000	$ 577,268,000
Platte River Power Authority (PRPA)	$ 181,400,000	$ 68,800,000
City Public Service Energy (CPSE)	$ 2,068,686,000	$ 1,034,024,000
Seattle City Light (SCL)	$ 741,602,580	$ 141,500,000
Sacramento Municipal Utility District (SMUD)	$ 1,314,741,000	$ 412,561,000
Orlando Utilities Commission (OUC)	$ 876,009,000	$ 445,692,000

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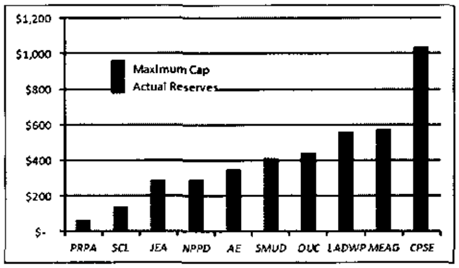
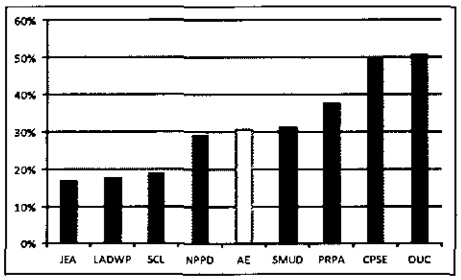
Reserve Fund Comparison



Reserve Funds

($ in millions)



Reserve Fund

as % of Revenues

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Need for Reserves

- Business risks of utilities are increasing:
  - fuel price volatility, counterparty risk
  - major generation disruptions due to nuclear events, unplanned outages, water curtailment
  - the need for extensive capital expenditures for infrastructure improvement
  - significant environmental legislation that increase costs but not output
  - threat of emergency expenditures in response to natural disasters and catastrophic weather events
  - the incurrence of large deferral amounts during a period of capped rates
- Rating agencies, recognizing increased utility risk, have focused on Reserves and Days Cash on Hand as a mitigating factor for increased risk.
- Utilities owning generation have a higher risk profile
  - 70% of AE's cost is generation related

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Definition of Reserves, Financial Policies

Description	Policy #	Date Adopted	Date Revised	Target Amount	Current Amount FY2012 Budget Ending Balance	Target Amount	Test Year Revenue Requirement	# Years to Replenish per Financial Policy	# Years to Replenish in Rate Proposal
Operating Cash	11	FY1989	N/A	Maintain 45 days of budgeted operations and maintenance expense, less fuel.	$38,000,000	$51,668,168	$-0-	Not specified.	3 years
Repair and Replacement	15	FY2002	FY2012	Maximum of 50% of previous year's electric utility depreciation expense.	$64,071	$61,197,672	$20,399,224	Not specified.	3 years
Non-nuclear decommission-ing	21	FY2002	N/A	Funding will be set aside over a minimum of four (4) years prior to the expected plant closure.	$8,000,000	$55,577,818	$5,557,782	Funding will be set aside over a minimum of four (4) years prior to the expected plant closure.	10 years

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Definition of Reserves, Financial Policies

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Strategic Reserve – Emergency	16	FY1997	FY2002	Minimum of 60 days of non-power supply operating requirements.	$68,890,890	$68,890,890	$-0-	Not specified.	N/A. Currently fully funded.
Strategic Reserve – Contingency	16	FY1997	FY2002	Maximum of 60 days of non-power supply operating requirements 60 days.	$68,701,568	$68,890,890	$189,322	Balance will be replenished to the targeted amount within two (2) years.	Currently deficient.
Strategic Reserve – Rate Stabilization. Previously named Competitive Reserve.	16	FY1997	FY2012	Maximum 90 days of non-power supply operating requirements	$ -0-	$98,158,450	$3,946,811	Not specified.	3 years
GRAND TOTAL					$183,656,529	$404,383,888	$30,093,139		

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Revenue Requirements

January 31, 2012 | 6

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What are Revenue Requirements?

- Annual minimum needs of the Utility
  - Normalized to exclude non-typical items
  - Only includes assets that are used and useful

Cash Flow Methodolgy Revenue Requirement Components	*Final* Test Year	*Basis for* Recovery
Total Operations & Maintenance Expenses	824,379,485	Continue to provide core services
Debt Service	168,070,290	Bond Covenant and Financial Policy Compliance
General Fund Transfer	105,000,000	Financial Policy Requirement
Capital From Current Revenue	111,091,011	Funding requirements within Financial Policy guidelines
Other net (Non-Rate) Revenue	(93,562,762)	Transmission Revenue, Interest Income, Other Revenue
Total Revenue Requirement minus Reserves	$ 1,114,978,025	

- Reserves are added to cover non-typical events
  - The only discretionary part of the Utility's Return
    - Contributions to Decommissioning Reserves - $5,557,782
    - Required Contributions to Reserves - $24,535,357

January 31, 2012 | 7

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Reserves Provide Funding for Non-Typical Costs

Cash Flow Methodolgy Revenue Requirement Components	Final Test Year	Basis for Recovery
Contributions to Decommissioning Reserves	5,557,782	Financial Policy Requirement-Fund depleted
Required Contributions to Reserves	24,535,357	Financial Policy Requirement-Funds depleted

Existing reserve balances are available for unplanned events such as:	
Replacement power for one nuclear unit	$ 43,000,000
Fuel cost Increase 50%	$ 45,000,000
Market spike in August 2011 during unplanned outage	$ 30,000,000
2008 Financial Crisis-loss of access to capital markets due to high interest cost	$ 29,000,000
2008 Financial Crisis-remedy bond ordinance provision due to loss of Surety	$ 44,000,000
Water Curtailments	possible threat
Storm Damage from wind, ice, fire, etc.	possible threat
Insurance Claims	possible threat

Additional reserve balances are needed for major generation expansion such as:	
Addition of Selective Catalytic Reduction (SCR) Devices-FPP	probable addition
Base load Plant additions (Generation capacity needed in ERCOT)	$ 225,000,000
Purchase Options for wind farms	$ 200,000,000

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Managing Cash

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Managing Cash

Balancing of:

- Debt
- Equity (Reserves and Rates)

The debt to equity ratio is a leverage ratio indicating the relative proportion of equity and debt used to finance a utilities assets.

Low Debt/Equity → Low Risk to Utility & Customers → Minimizes Utility's Fixed Payments

High Debt/Equity → Aggressive Financing Increases Risk to Utility & Customers → Increases Utility's Fixed Payments

Changing the internal cash funding of future construction will not alter the current revenue requirement. Revenue requirements are based on actual, historical data and accepted known and measurable adjustments.

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Moody's Report - November 2011

- **Debt Ratio (3 year average)**

Aaa Rating → Debt should be less than 25%

Aa Rating → Debt should be in the range of 26-50%

At 50%, Austin Energy is at the high end of the Aa range.

Because utilities are both capital intensive and have an obligation to serve, it is important that they have highly rated debt. Higher ratings allow utilities to finance at lower rates which reduces customer cost. Once a utility is down rated, it takes a long time to rebuild a rating.

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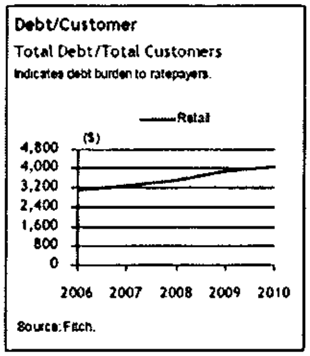
Fitch U.S. Public Power Peer Study - June 2011

- Debt/Customer – debt burden to ratepayers:
  - Austin Energy @ $3,416
  - Industry median for "AA-" rated senior debt @ $3,265



"AA-" Rated Senior Debt	Debt/ Customer ($)
Anaheim Electric Utilities Fund, CA	5,730
Austin Energy, TX	3,416
Bountiful Electrical System, UT	-
Eugene Electric Board, OR	2,953
Floresville Electric Light & Power System, TX	1,133
Gallup Joint Utilities Fund, NW	2,370
Georgetown Utility Funds, TX	3,265
Heber Light & Power Company, UT	1,210
Hydro-Quebec	9,641
Jacksonville Beach Combined Utility Funds, FL	1,144
JEA - Electric System and Bulk Power Supply System, FL	7,514
Kerrville Public Utility Board, TX	415

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Impact of Increasing Debt (Hypothetical Example)

Original Capital Structure Assumptions: | Results

Debt Service (P&I)	$ 15	Debt	$ 100	
Net Income	$ 40	Equity	$ 100	
Debt Service Coverage	2.40	Debt/Equity	50%	

Change in Original Assumptions-*Increase in Debt*:

Debt Service (P&I)	$ 20	Debt	$ 150 ↑	Opposite of Rating Criteria
Net Income	$ 35	Equity	$ 95 ↓	
Debt Service Coverage	1.41 ↓	Debt/Equity	61% ↑	

- Cash and Assets would be the same as the total Debt and Equity.
- Cash is higher but your fixed costs are increased and your next bond issue may require higher interest payments in the future.

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Business Risk (Equity) Versus Financial Risk (Debt)

- Business risk reflects
  - operating risk of the utility (i.e., market spikes, unplanned outages & events)
  - net operating income will not be as expected (i.e., decline in sales)
- Financial risk reflects
  - the presence of fixed-payment capital (i.e., debt)

A utility can control its overall level of risk by adopting a more conservative capital structure (i.e., using more equity) if its business risk is increased.

The more debt a utility has, the greater the financial risk. This is simply because debt represents a fixed cost that must be paid under any circumstance.