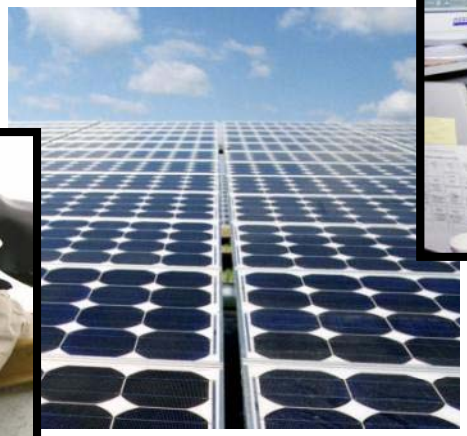


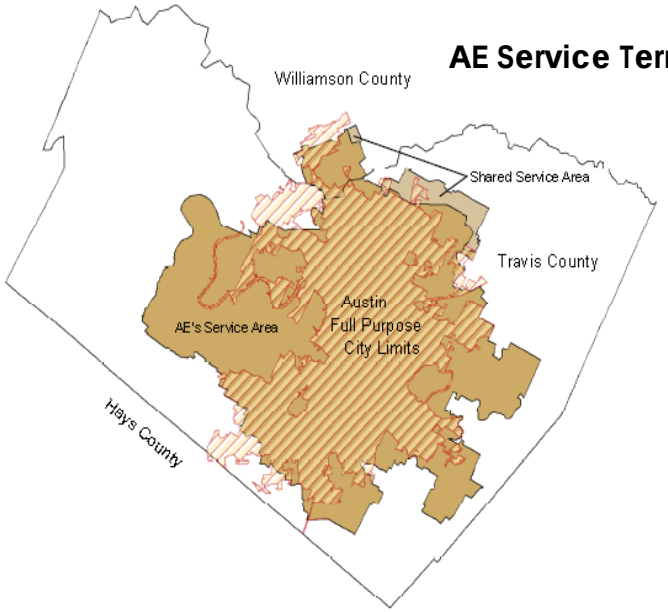
City of Austin, Texas
Austin Energy

Business Model
November 4, 2009

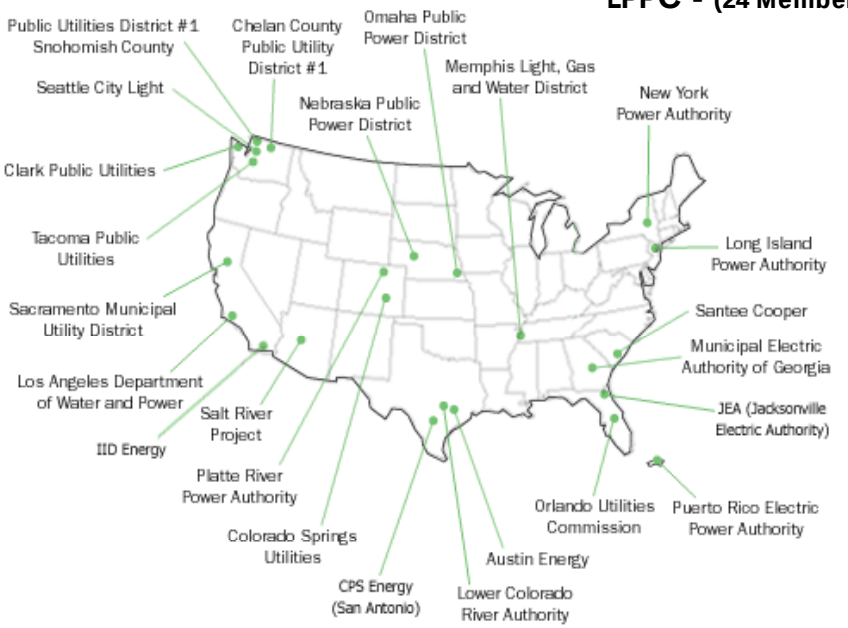
Overview

- 9th largest public power electric utility in U.S.
- 437.06 square mile service territory
  - City of Austin and parts of Travis & Williamson Counties
- Over $3.5 billion assets
- Over $1.0 billion annual revenue
- Retail electric provider for 400,000+ customers
- 1,721.75 full time employees

AE Service Territory



Large Public Power Council
LPPC - (24 Members)



Financial Condition – Currently Sound

- Strong economic & demographic characteristics of service territory with a diversified customer base
- Competitive retail rates relative to other Texas utilities
  - Separate cost-recovery allows annual true-up for fuel & purchased power costs
- Diverse power supply mix
- Sound financial record & strong liquidity
  - Maintain at least 45 days operating cash
  - Solid combined debt service coverage (DSC) - historically at or above 2.0x on both prior- & working-lien revenue bonds
  - Strategic reserve of 120 days cash for contingencies & emergencies

Credit Rating & Debt Position

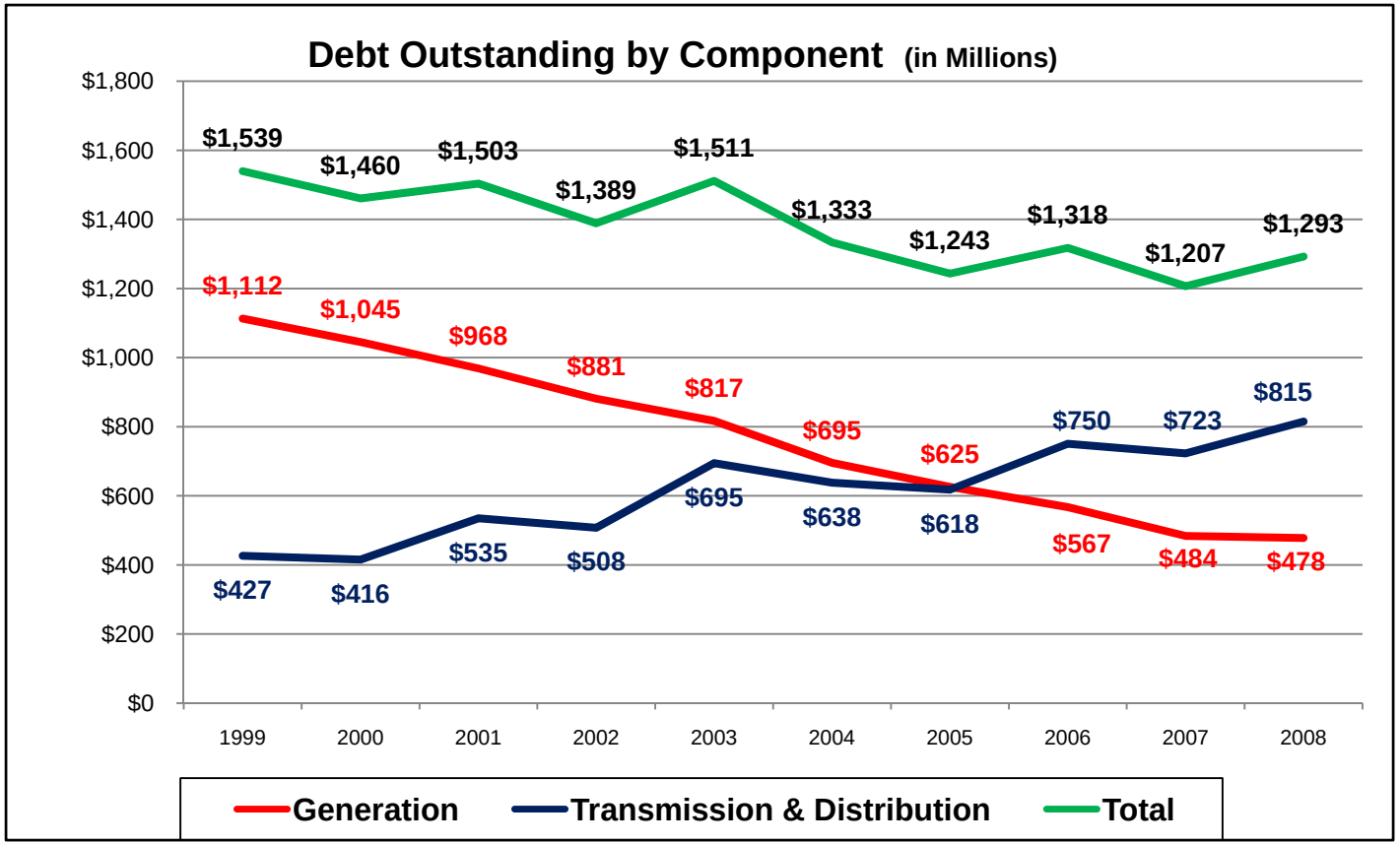
Debt	Ratings		
	Fitch, Inc.	Moody's Investors Service, Inc.	Standard and Poor's
Utility revenue bonds – prior lien	AA- Stable	A1 Positive	AA Stable
Utility revenue bonds – subordinate lien	AA- Stable	A1 Positive	AA Stable
Utility revenue bonds – Electric separate lien	AA- Stable	A1 Positive	A+ Positive

- Combined Utility System Bonds
  - Pledge of electric, water & wastewater revenue
  - Closed lien - no longer issuing bonds
- Parity or "separate lien" electric utility revenue bonds
  - Pledge of only electric revenue
  - Issued in 2001 & thereafter

		9/30/1997	9/30/2008
Combined Utility Systems Obligations - Electric Portion			
Prior First Lien Obligations	$	1,513,937,743	231,056,221
Prior Subordinate Lien Obligations		145,902,811	102,975,072
Combined Utility Systems Obligations - Electric Portion Subtotal		1,659,840,554	334,031,293
Parity Electric Utility Obligations		-	1,008,576,484
AE Total Revenue Bonds	$	1,659,840,554	1,342,607,777
1997 to 2008 Net Debt Reduction	$		317,232,777
Average Net Principal Reduction per Year	$		28,839,343

Debt Facts

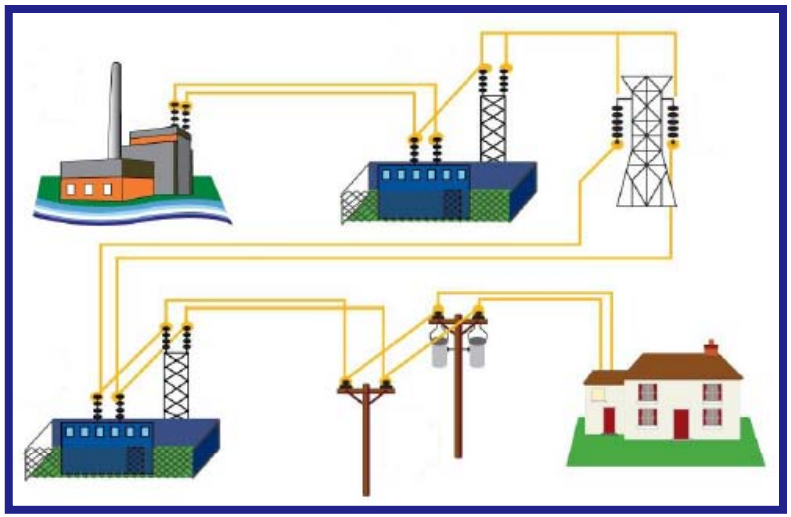
- $1.3 Billion total outstanding revenue bonds at 9/30/2008
- FY2010 $181 M debt service payments
- FY2010-2014 Forecast $685 M new debt issues



Traditional Business Model

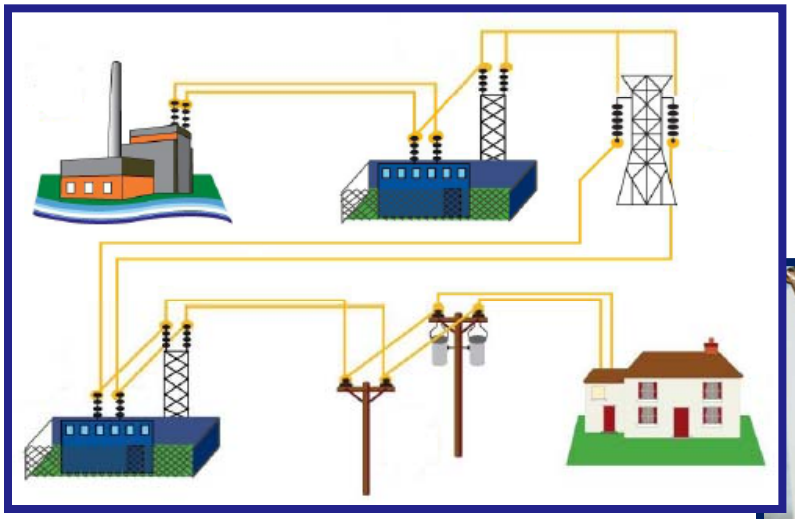
- Central power plants & large scale production reduce cost (Sam Insull)
- Exclusive utility franchise (monopoly rights) with an "obligation to serve" all customers in defined regions
- Base rate recovers non-fuel costs
  - Generation, transmission & distribution capital plus rate of return
  - Expenses (with no rate of return)
- Fuel rate recovers fuel cost, ERCOT fees, purchased power
  - No profit added

Traditional Vertically Integrated Utility



Challenges on Horizon

- Financial storm clouds on horizon
  - Current challenges
  - New challenges
- Need to begin addressing these challenges



Current Challenges

Current Challenges

1. Workforce issues
2. Transmission Rider
3. General Fund Transfer (GFT) Policy
4. Rate increase needed in forecast

Workforce Issues

Industry Issue – Aging Workforce

- 45% of APPA 2008 Survey respondents reported more than 20% of their work force eligible to retire in next 5 years
- Positions with the most retirements in next 5 years will be most difficult to replace
  - First line supervisors, senior managers, executives
  - Skilled trades, engineering professionals, system operators
- Loss of critical knowledge & skills
- Increasingly difficult to recruit qualified replacements with utility-specific skills
- Economic recovery will intensify these problems

AE Workforce Issues

- Retirement
  - 35%-40% of AE workforce eligible by 2010 – 2011
  - Almost 50% of Power Production workforce eligible by 2010 – 2011
  - 40% of Conservation workforce eligible now
- Recruitment
  - University sources of electrical engineers declining
  - Few sources & competition fierce for skilled trade workers, power plant workers, system operators, traditional utility professionals
  - Easier to attract talent for "Green" than "traditional utility" positions
- Retention
  - Critical role talent often leave within first 10 years
    - Trained for utility-specific jobs, then highly marketable
  - Limited upward mobility for mid-level due to lower turnover for employees with 15+ years tenure remaining until retirement eligibility
  - Leave for better paying opportunities at other utilities

AE Workforce Issues

- Want to hire Knowledge, Skills & Abilities (KSA) equivalent of retirees
  - Shortage of ready-now talent
  - Gap in knowledge, skills & abilities of new hires versus those leaving
  - Cannot fill position until employee retires – limits training/mentoring
  - Increased time & cost to develop entry level employees
  - Can take up to 3 – 5 years to bring new employees up to productivity levels
- "Double hiring" - retirees return to supplement workforce
  - Hire Full Time Equivalent (FTE) & rehire retire (limited to 29 hours/week)
    - 1 FTE + 29hr/40hr Temporary Retiree = 1.73 FTEs
    - FTE with full benefits; retiree as temp with no benefit cost
  - Retirees train/mentor & continue supporting workload
- Contracts restrict AE's hiring of contractor's workforce
  - Contractor's employees want City employment due to retirement benefits

AE Workforce Initiatives

- Knowledge transfer
  - Automating & documenting processes
  - Mentoring by skilled workers with less experienced
  - Streamline training & development
- Retention of workers with retirement eligibility
- Recruiting efforts stepped up
- Talent Management System
- Job Rotation Program to develop & discover AE talent
- Career & Leadership Development Programs
- Internship Program creates student pipeline into workforce
- Austin Community College programs (Power & Renewable Technology, Linemen)
- Green Jobs - community coordination on training

AE Workforce Issue – Management

Retirement Eligibility & Vacant

Current as of 9/2/2009

Currently Vacant	10
Currently Eligible	15
Within One Year	3
Within 3 Years	10
Within 5 Years	7
TOTAL	**45**

Total Management Positions **74**

- 30% currently eligible or vacant
- 61% of management positions eligible to retire within 5 years or vacant
  - 8% are executive positions
- Executives eligible to retire now
  - General Manager
  - Utility Chief Financial Officer
  - Chief Administrative Officer
  - Director, Corporate Communications
- Executive positions vacant
  - VP Power Production
  - VP Electric Service Delivery

AE Workforce Issues

- Large Public Power Council Annual Salary Survey
- Municipal equity concerns versus public power market reality

- Recommendation
  - Continue AE Workforce Initiatives – Retention, recruitment, training, skills development
  - Implement market study results

Transmission Rider Tariff

Transmission Rider

- Transmission expense growing faster than transmission revenue
- Ongoing Texas transmission build-out cost
  - Includes Competitive Renewable Energy Zones (CREZ $5+ billion)
  - CREZ adopted Fall 2008 by Public Utility Commission of Texas
  - Allocated per State law by Public Utility Commission of Texas (PUCT) to all utilities in Electric Reliability Council of Texas (ERCOT) region
  - Allocated based on utility's peak load as % of ERCOT's peak load
- Recommend Transmission Rider to address cost recovery
  - AE's transmission expense (TCOS) for use of Texas grid $64M in FY 2010 & expected to double in 5 years
  - Cost recovery method (no profit) to recover growth in AE's portion of Texas transmission cost
  - Postponed from FY2010 to FY 2011 budget

Transmission Rider

- Transmission expense or cost of service (TCOS) and cost (under)/over recovery

AUSTIN ENERGY
TCOS & Transmission Cost Recovery

	Year	AE TCOS Payments	AE Base Rate Transmission Cost Recovery	(Under)/Over Recovery	Cumulative (Under)/Over Recovery
	2003	37,451,515	42,869,296	5,417,781	5,417,781
	2004	41,350,956	42,482,880	1,131,924	6,549,705
	2005	42,482,272	45,034,349	2,552,077	9,101,782
	2006	46,136,660	46,816,354	679,694	9,781,476
	2007	49,083,543	46,632,961	(2,450,582)	7,330,894
	2008	51,256,538	50,018,794	(1,237,744)	6,093,150
	2009	61,976,538	50,002,089	(11,974,449)	(5,881,299)
Estimate	2010	64,055,747	49,148,735	(14,907,012)	(20,788,311)
Estimate	2011	73,803,894	49,981,788	(23,822,106)	(44,610,417)
Estimate	2012	89,247,757	50,741,003	(38,506,754)	(83,117,171)
Estimate	2013	106,706,280	50,688,899	(56,017,381)	(139,134,552)
Estimate	2014	126,149,871	51,198,207	(74,951,664)	(214,086,216)
Estimate	2015	146,869,031	51,784,946	(95,084,085)	(309,170,301)

TCOS = Transmission Expense or Cost of Service

General Fund Transfer Policy

General Fund Transfer (GFT)

General Fund Transfer (GFT) Formula

$$\frac{y2 + y1 + y0}{3} \times R = GFT$$

- GFT formula input
  - **y2** = Actual revenue, 2 years prior to current fiscal year
  - **y1** = Actual revenue, 1 year prior to current fiscal year
  - **y0** = Estimated revenue, current fiscal year
  - **R** = Transfer Rate
  - **GFT** = General Fund Transfer for next fiscal year

- Revenue used in GFT calculation
  - Service Area Sales of Electricity
    - Base revenue
    - Fuel revenue
  - Other Revenue
    - Transmission Revenue
    - Infrastructure Rental
    - Product Sales
    - Customer Fees
    - Bilateral Wholesale Sales
    - Other revenue such as lab fees, rental, scrap sales
  - Interest Income

American Public Power Association

- *"Payments & Contributions by Public Power Distribution Systems to State & Local Governments, 2006 Data"* March 2008 Report
  - Payments in lieu of taxes, property-like taxes & general fund transfers
  - 382 public systems – median 5.0% of electric operating revenue
  - 39 public systems with revenue of $100+ million
    - Median 5.6% and 50% of utilities transfer between 3.1% - 6.8%
  - 28 public systems in West South Central region
    - Median 7.1% and 50% of utilities transfer between 3.2% - 12.1%
- Compare 2006, 2004, 2002 and 2000 Survey Data

APPA Reports	Data Year	# of Utilities	Median
Revenue ($100+ million)	**2006**	**39**	**5.6%**
	2004	**31**	**6.3%**
	2002	47	6.6%
	2000	46	6.1%
Region - West South Central (Arkansas, Louisiana, Oklahoma & Texas)			
	2006	**28**	**7.1%**
	2004	**27**	**8.4%**
	2002	43	8.8%
	2000	46	8.1%
Total All Utilities Surveyed	**2006**	**382**	**5.0%**
	2004	**343**	**5.3%**
	2002	573	5.8%
	2000	537	5.7%

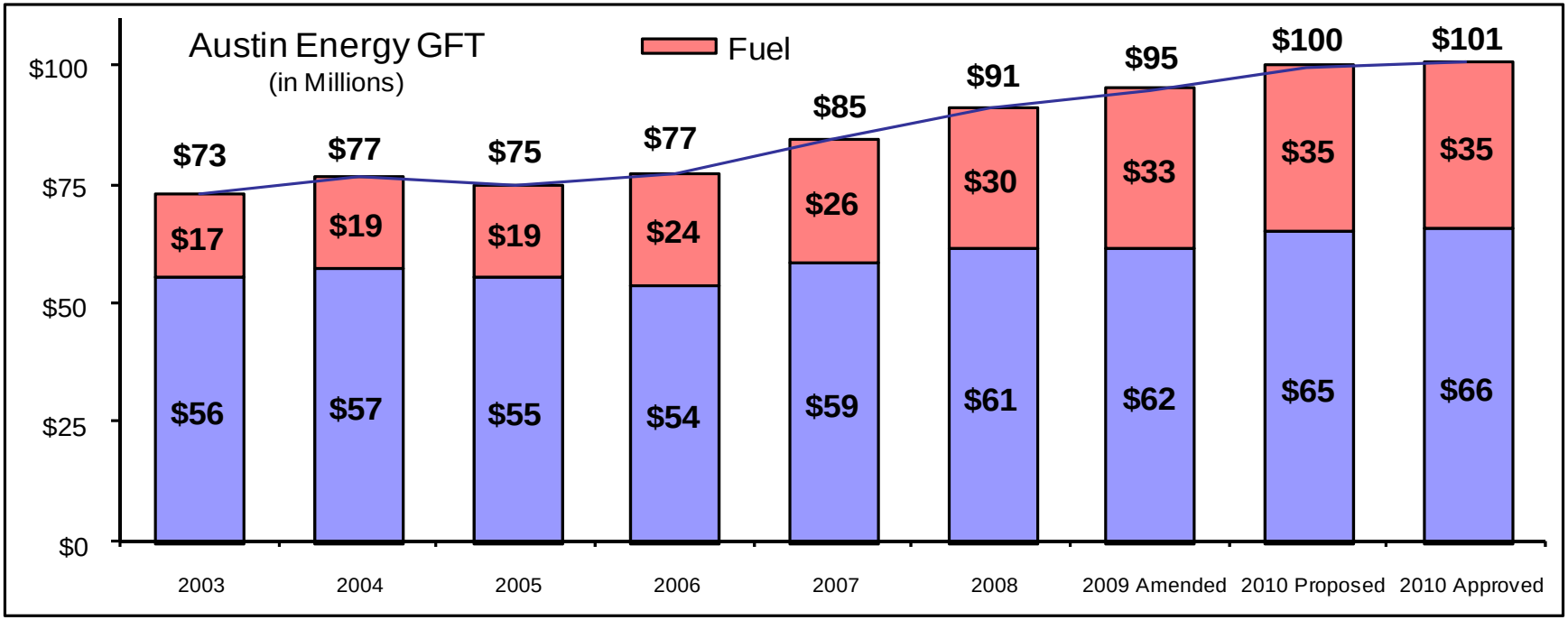
General Fund Transfer (GFT)

EXAMPLE

- Assume Fuel cost of $100,000,000
  - Cost pass thru to customer with no profit
- Bill customers & collect $100,000,000 fuel revenue
- Utility payments of $109,100,000
  - Pay $100,000,000 Fuel cost
  - Pay General Fund Transfer (GFT) on Fuel Revenue of $100,000,000 at 9.1% transfer rate = $9,100,000
- Net income (loss) of ($9,100,000)
  - Rising fuel costs cause net income to decline at faster pace

Current fuel cost about 4x greater = Net (loss) of $35 M

General Fund Transfer



- Transfer % of Gross Revenue - 9.1% since 1999, except 8.9% in 2002
  - 3 year average of 2 prior year's actual & current year estimate
  - Public power's most commonly used transfer method
- Transfer formula includes fuel revenue
  - Fuel revenue - cost pass thru to customer with no profit
  - Contributes to declining net income
- Fuel portion growing at faster rate than GFT related to base revenue

General Fund Transfer (GFT)

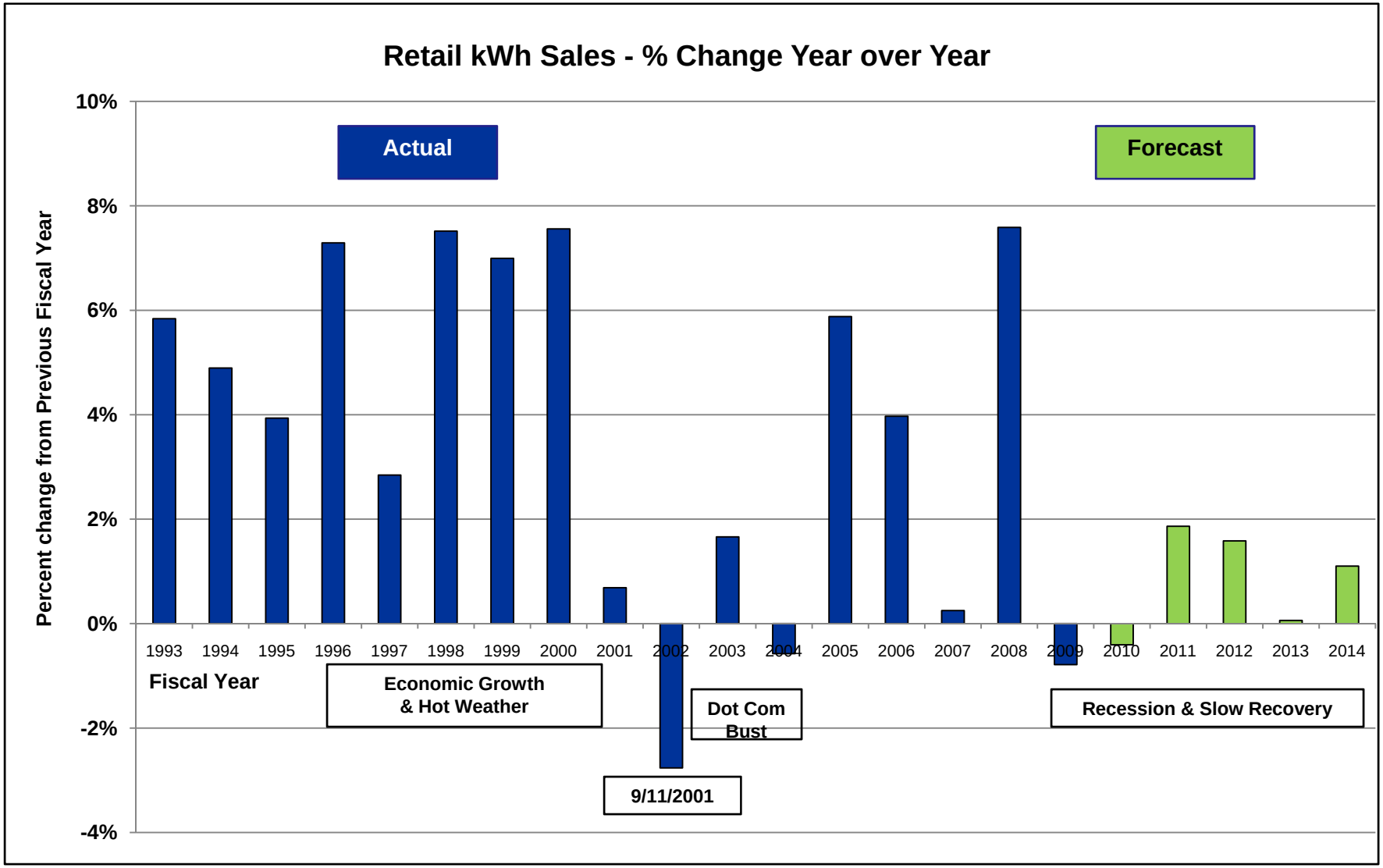
Recommendations for further study

- 9.1% only on non-fuel revenue, reduces GFT
- Increase % of non-fuel revenue to achieve same GFT $$$
- Fixed rate per kWh Sold
  - Based on kWh, not revenue
- GFT % added in Fuel Tariff
  - Fuel tariff revised to recover fuel cost plus GFT %
- Other options

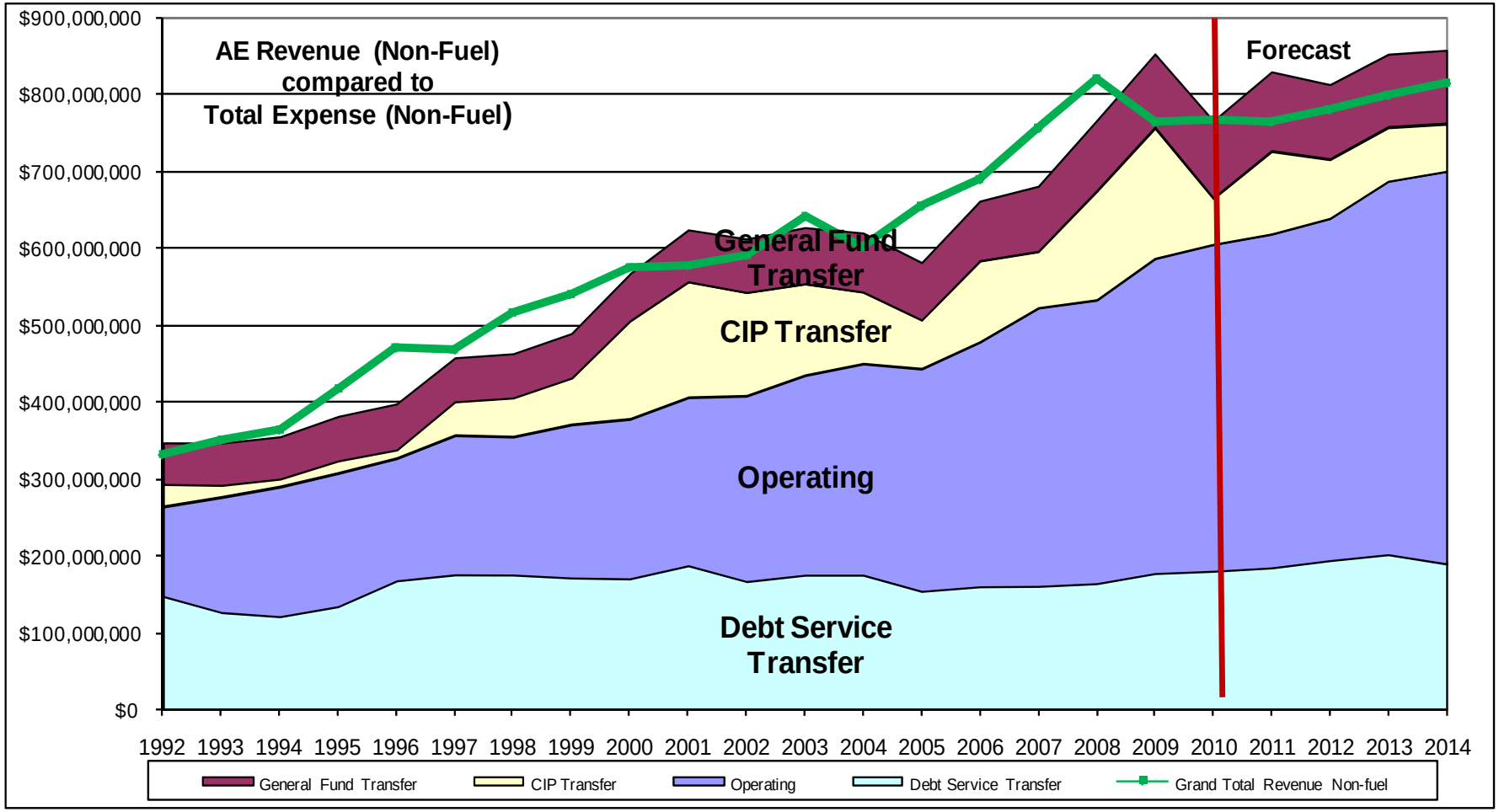
City Financial Services & Austin Energy
will bring back a recommendation to Council on
General Fund Transfer Policy.

Rate Increase Needed in Forecast

Retail kWh Sales Growth - % Change



History & Forecast



Operating Requirements

- Increasing expenses for distribution build-out, smart grid, energy efficiency programs, new employees, program cost increases
- Current programs, but not in 1994 rate base
  - Growth in conservation programs
  - Austin Climate Protection Program
  - Solar Rebate Program
  - Smart Meters installed at no cost to AE customers
  - Increases in AE's transmission expense for Texas grid build-out
  - Maintenance on Sand Hill Energy Center (spikes every 3 years)
  - Qualified Scheduling Entity & Energy Hedging
  - ISO Quality Management Program
  - 311 Call Center
- As operating costs grow, less internal funding available for capital improvements
- Results in lower "bottom line" or net income

Income Statement Metrics

AUSTIN ENERGY
INCOME STATEMENT

Financial Metrics declining from 2002 to 2009:
---Net Operating Margin
---Net Income(Loss) as % of Operating Revenue

		2002	2003	2004	2005	2006	2007	2008	12 Months June 2009
Operating Revenues	$	745,095	921,649	829,018	$ 972,846	$ 1,070,606	1,056,488	1,217,735	1,225,647
Total Operating Expenses		491,692	643,992	612,382	719,062	821,515	826,347	970,799	1,026,767
Net Operating Income		253,403	277,657	216,636	253,784	249,091	230,141	246,936	198,880
Net Operating Margin		**34%**	**30%**	**26%**	**26%**	**23%**	**22%**	**20%**	**16%**
Net Income (Loss)	**$**	**105,453**	**118,068**	**(6,290)**	**110,481**	**121,699**	**90,993**	**108,881**	**38,777**
Net Income (Loss) as % of Op Revenue		**14.15%**	**12.81%**	**-0.76%** (a)	**11.36%**	**11.37%**	**8.61%**	**8.94%**	**3.16%**

(a) Impact of accounting for revenue bond refunding - transaction for present value savings.
Also 2004 was a cool, wet summer impacting operating revenue.

- Revenue growth slows
- Expenses growing faster than revenue
- Operating margin declines from 34% in 2002 to 20% in 2008
- Net income declines from 14% of revenue in 2002 to 9% in 2008 & expect sharp decline in 2009 & thereafter in forecast

Forecasts & Rates

What have we said publicly about rate increases?

- FY2007-2011 Forecast - rate increase may be needed in 2010
- FY2008-2012 Forecast - rate increase may be needed in 2011
- FY2009-2013 Forecast
  - Better financial results in FY2006 & FY2007 (Revenue above budget & expenditures under budget)
  - Samsung & HP expansions planned in forecast
  - Defer base rate increase
- FY2010-2014 Forecast – need rate increase & restructuring in forecast
  - September 2009 financial markets crisis & recession
  - Impact on technology customers –significant consumption declines & planned expansions deferred
  - Fall 2009 Public Utility Commission of Texas adopts CREZ plan ($5+ billion)
  - Recovery period & strength of recovery uncertain

Rate Increase - FY2010-2014 Forecast

Austin Energy Department Five Year Forecast
(millions)

	Amended 2008-09	Estimated 2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
BEGINNING BALANCE	320.8	242.7	160.5	58.5	(9.3)	(45.3)	(105.3)
TOTAL REVENUE	1,276.5	1,208.4	1,223.4	1,225.9	1,243.6	1,251.9	1,259.7
TRANSFERS IN	43.2	43.2	0.0	0.0	0.0	0.0	0.0
TOTAL AVAILABLE FUNDS	1,319.7	1,251.6	1,223.4	1,225.9	1,243.6	1,251.9	1,259.7
TOTAL OPERATING REQUIREMENTS	935.3	855.2	887.3	888.5	905.0	944.1	964.9
TOTAL TRANSFERS OUT	428.7	461.7	421.1	388.1	357.0	349.7	347.8
TOTAL OTHER REQUIREMENTS	16.9	16.9	17.0	17.1	17.6	18.0	18.5
TOTAL REQUIREMENTS	1,380.9	1,333.8	1,325.4	1,293.7	1,279.6	1,311.8	1,331.2
EXCESS (DEFICIENCY) OF TOTAL AVAILABLE FUNDS OVER TOTAL REQUIREMENTS	(61.2)	(82.2)	(102.0)	(67.8)	(36.0)	(60.0)	(71.5)
ENDING BALANCE	259.6	160.5	58.5	(9.3)	(45.3)	(105.3)	(176.8)
FTEs	1,718.75	1,718.75	1,718.75	1,718.75	1,718.75	1,718.75	1,718.75

- Electric sales (non-fuel) $160 M lower forecast than last year's due to economic factors
- Electric rate increase (non-fuel) & restructuring needed in forecast
- Transmission expense increases $125 M in forecast due to ongoing Texas transmission build-out including CREZ or Competitive Renewable Energy Zones - $5+ Billion

Local Control over Rates

Base rates in effect since 1994

- Utility requested 14.83% system average increase in base
- Council approved base rate increase – 10.90% system-wide

Rate Setting Process

- City Council – Set Policy, Rates, Service Rules & Regulations
  - Electric Utility Commission – Advisory to City Council
  - Public Hearings
- Public Utility Commission of Texas - Appeal available for outside City residential customers
  - 15% customers are Outside City
  - PUCT Appeal = About 2,500 Outside City residential customer signatures
- Rates are based on historical cost, not future

Planning for Base Rate Case

- Planning (1 - 3 years)
  - Load Research
  - Cost of Service Studies
  - Consultants (Financial, Engineering, Legal)
    - Review Operations Cost Structure
    - Review Capital Cost Structure
    - Legal issues
    - Rate case strategy
  - New Customer Billing System Implementation
  - Rate Design
  - Test Rate Design in Billing System
  - Communication Plan
  - Public Hearings

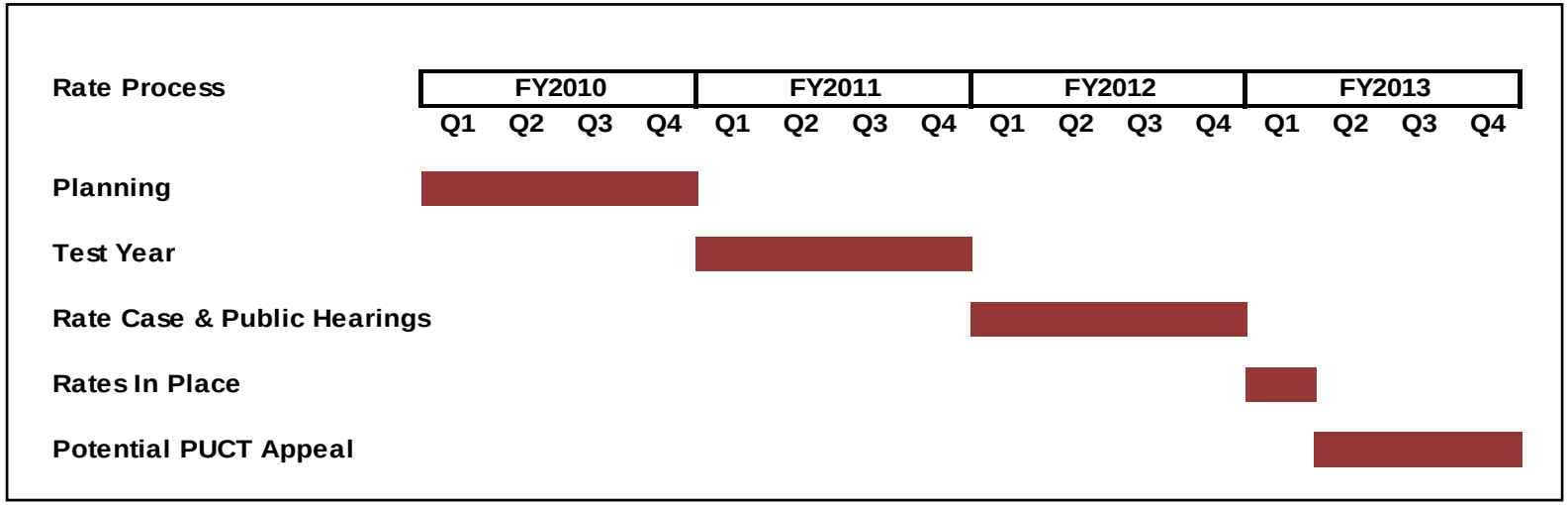
Rate Increase

- **Rate increase to be effective October 1, 2012 at beginning of FY2013**
  - 2011 Test year costs more reflective of future commitments
    - O&M costs for SHEC expansion & ERCOT State-wide Nodal market
    - CIP costs for System Control Center, Customer Information System, Inventory System
  - Reduced uncertainty in ERCOT statewide Nodal market
- **Issue – Equity among customer classes**
  - Large industrial customer contract rates expire May 2015 - exempt from rate increase
  - Residential and C&I customers bear rate increase
  - Low income customer issues
- **Risks**
  - Council support for rate increase & potential impact on credit rating
  - Potential for PUCT Appeal
    - PUCT Appeal = Need about 2,500 Outside City residential customer signatures

Rate Increase - Recommendations

- Begin planning in FY2010
- FY2011 Implement Transmission Rider to begin recovery of increased ERCOT grid costs
- Revenue increases or cost savings each year to balance forecast until rate increase
- Implement Customer Information System needed for new rate designs

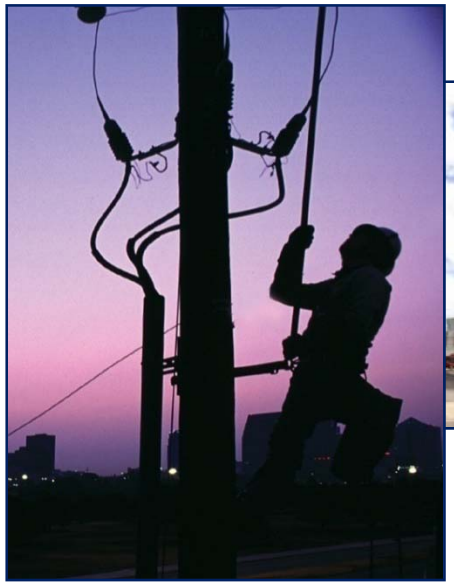
Rate Case - Calendar

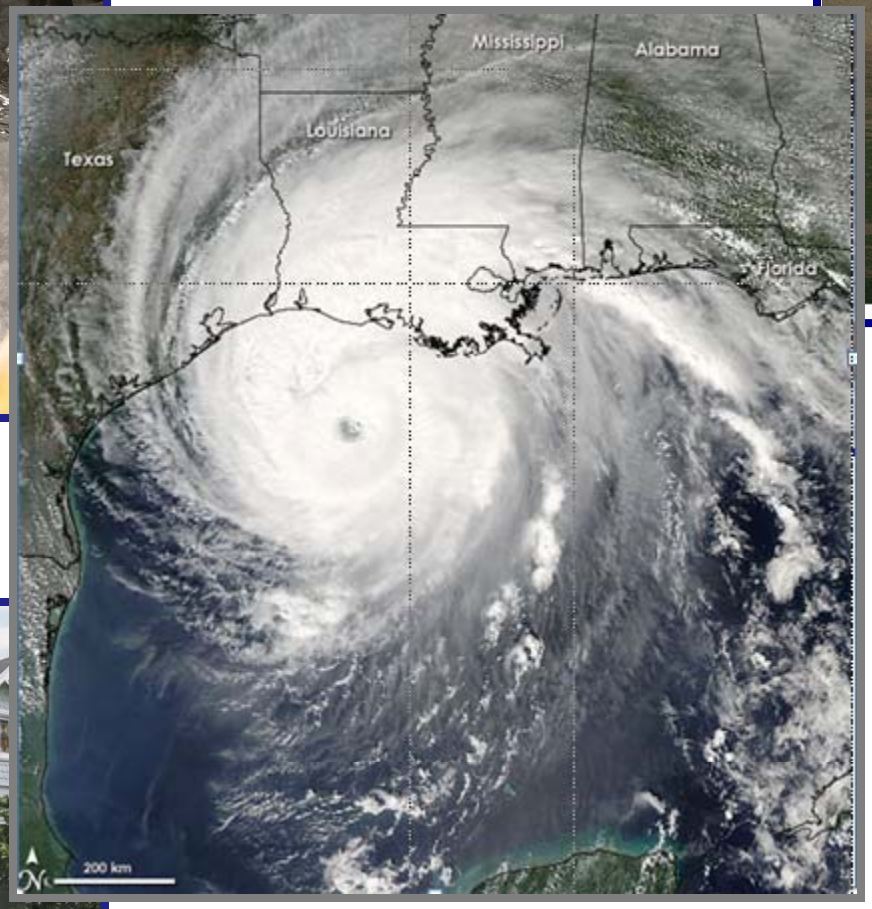


- Begin planning in FY2010
- FY2011 Test Year for rate case
- Rates to be effective October 1, 2012 at beginning of FY2013

Current Challenges - Recommendations

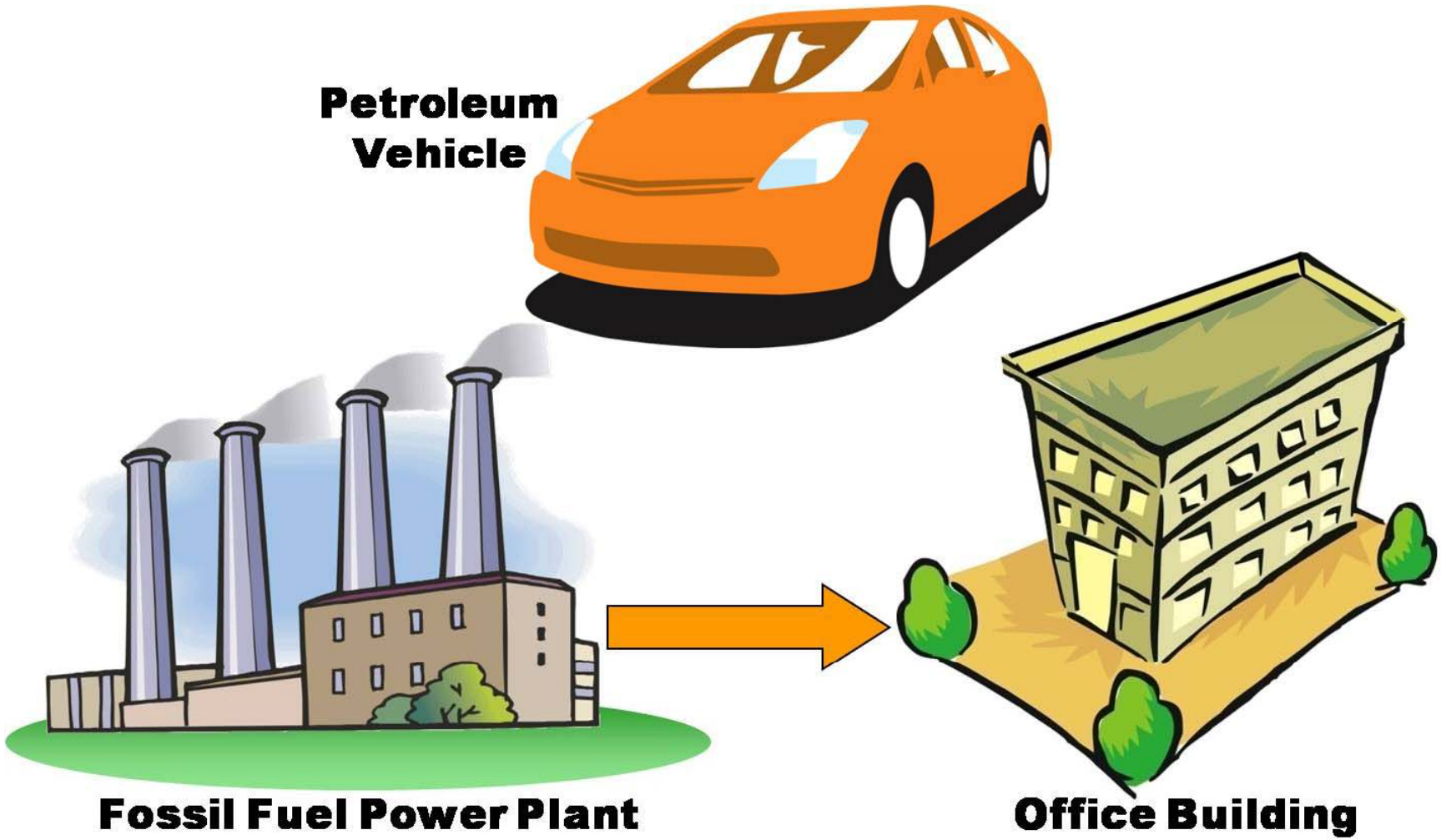
Challenge	Recommendation(s)
Workforce Issues	Continue AE Workforce Initiatives – Retention, recruitment, training, skills development
Workforce Issues	Implement market study results
Transmission cost recovery	Adopt Transmission Rider in FY2011 Budget
General Fund Transfer Policy – Fuel revenue	Review General Fund Transfer Policy and recommend policy revision going forward.
Rate increase in forecast period	Proceed with rate increase in FY2013 Budget



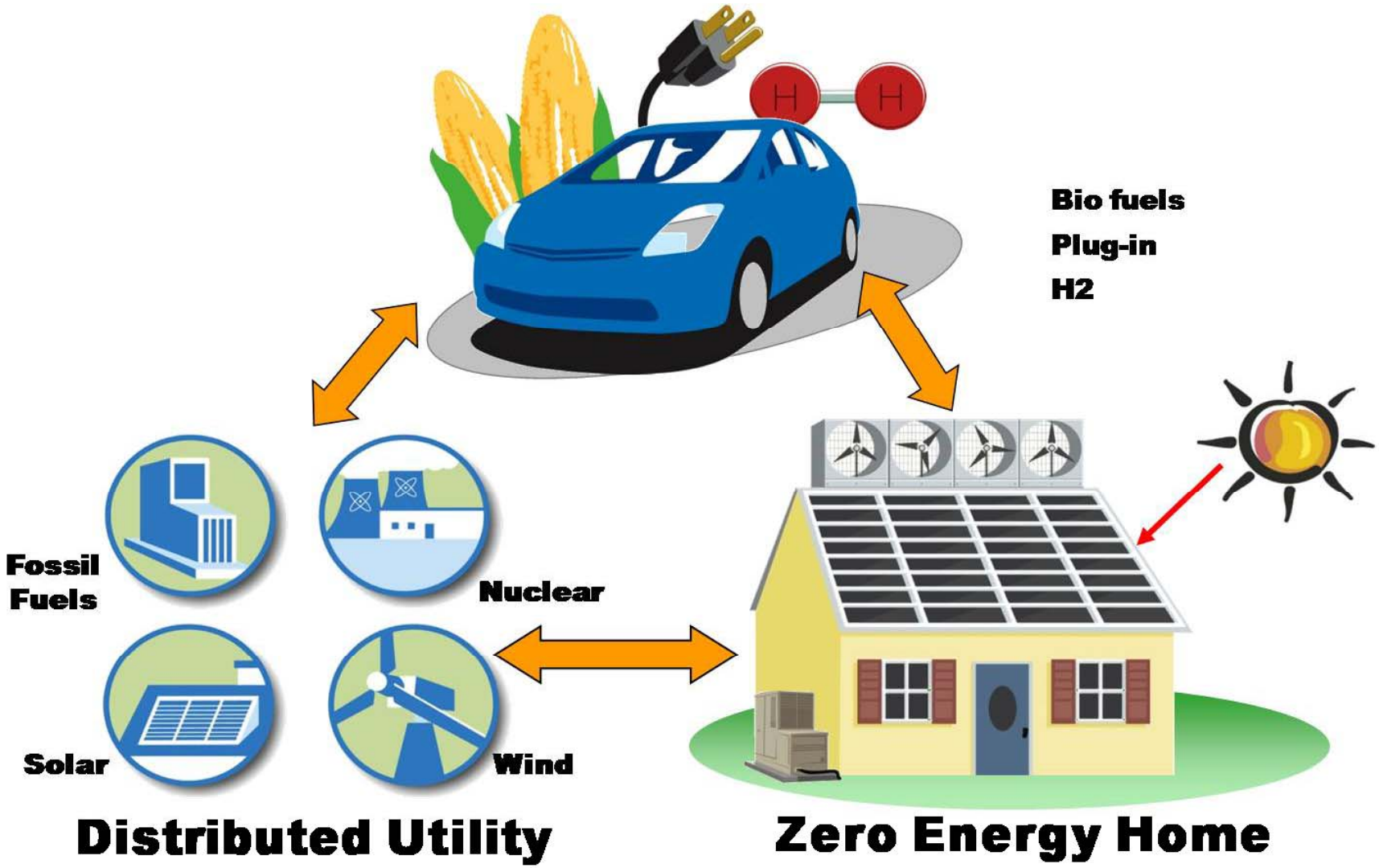


New Challenges

Conventional Energy System



Future Energy System



Challenges

- Distributed Generation – Buildings & Transportation
  - Cost Recovery
- New Products & Services
- Smart Grid
- Fuel Switching
- Energy Efficiency & Zero Energy Capable Homes (ZECH)
- Prosumerism – New relationship with customers
- Carbon
- National conversation on energy

Recommendations

- Change in rate structures
  - Unbundle rates
  - New rate design options
  - Mix of volumetric & fixed or service based rates to ensure cost recovery
  - Menu of rates
- Explore new Products & Services
- Re-evaluate method of delivery for energy efficiency
- Ownership & operation of renewable energy versus purchased power agreements (PPAs)
  - Rate of return if ownership; none if PPAs
- Re-evaluate GreenChoice® program
- Generation & CO^2 Plan

Recommendations Summary

Challenge	Recommendation(s)
Workforce Issues	Continue AE Workforce Initiatives – Retention, recruitment, training, skills development
Workforce Issues	Implement market study results
Transmission cost recovery	Adopt Transmission Rider in FY2011 Budget
General Fund Transfer Policy – Fuel revenue	Review General Fund Transfer Policy and recommend policy revision going forward.
Rate increase in forecast period	Proceed with rate increase in FY2013 Budget
Energy Efficiency & Zero Energy Capable Homes (ZECH) Distributed Energy Resources t	Change in rate structures with focus on cost recovery • Unbundle rates • New rate design options • Mix of volumetric & fixed or service based rates • Menu of rates Explore new Products & Services Re-evaluate method of delivery for energy efficiency Code changes phased in between now & 2015
Fuel switching - 30% renewable	Re-evaluate GreenChoice program Ownership & operation of renewable energy versus purchased power agreements (PPAs). Rate of return if ownership; none if PPAs.

Questions & Discussion