



FISCAL YEAR 2012 BUDGET REPORT

GENERAL INFORMATION REGARDING CPS ENERGY

Acquired by the City of San Antonio (City) in 1942, CPS Energy (the Company) is the nation's largest municipally owned energy utility that provides both natural gas and electric services. For the fiscal year ending on January 31, 2011, CPS Energy served more than 710,000 electric customers throughout its 1,514-square-mile service area while simultaneously serving more than 320,000 gas customers, mostly within the urban Bexar County area.

Low customer rates, a diverse electric-generating resource portfolio and strong financial management characterize CPS Energy. CPS Energy has a retail electricity rate that is well below U.S. averages. CPS Energy has a sound and balanced generation resource plan to meet customer demand through its fuel diversification program that includes nuclear, coal, natural gas, wind, solar and landfill gas. CPS Energy also has a fuel-hedging program to help mitigate natural gas price volatility.

In its financial ratings, CPS Energy's historically high credit rating enables it to obtain low interest rates when financing new projects or refinancing existing debt. These high ratings are primarily attributed to an experienced and prudent management team; a moderate debt burden; consistently strong debt service coverage ratios; competitive retail electric rates; solid liquidity; and a monthly fuel and purchased power pass-through mechanism that insulates financial performance from market and operational volatility.

While its gas business operates competitively, CPS Energy remains outside of the Texas retail choice market. The San Antonio City Council passed a resolution in 2001, electing not to opt-in to the deregulated electricity market. CPS Energy remains dedicated to offering a wide range of pricing options and programs for its community, ensuring its customers receive the full benefits of community ownership. With a diversity of energy sources and support of economic development in San Antonio, CPS Energy works closely with community leaders to continually grow its metropolitan market and benefit the community. With some exceptions, CPS Energy returns approximately 14% of its gross revenues to the City of San Antonio. Since 1942, CPS Energy has provided more than \$4.9 billion in payments to the City, which support important services such as those provided by the fire and police departments.

CPS Energy continues to place strong emphasis on strategic planning to remain a leader in the utility industry and to continue to be a valuable asset, providing reliable, low cost energy, which improves the quality of life for its customers in Greater San Antonio. CPS Energy's goals to be #1 in customer satisfaction and improve and sustain an engaged workforce are supported through initiatives that are funded through its Operating & Maintenance (O&M) and Capital Budgets. CPS Energy has allocated funding for specific programs, initiatives and activities to support the Company's key strategies.

SAN ANTONIO AREA ECONOMIC PROJECTIONS

CPS Energy's planning process considers national, state and local economic trends. Although, the local economy differs from the broad national landscape often resulting in more moderate peaks and valleys, the San Antonio metropolitan economy has more moderately slowed down since late 2007. Accordingly, San Antonio continues to systematically grow its economy, as indicated by recent publications, naming it as one of the nation's best performing and strongest metropolitan areas (Brookings Institute, Business Week, and Forbes).



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Customer growth in the San Antonio market is forecasted to continue, although it is anticipated that the rate of growth will be less than the level experienced between 2006 through 2008, when new home construction peaked. Since that time, the local housing market has softened, but growth is continuing in response to economic development, which continues to draw new companies to San Antonio.

The prospects for the San Antonio economy remain positive as it continues to position itself as one of the most dynamic economies in Texas and in the United States. Even with the current economic conditions, the San Antonio metropolitan area is expected to experience continued strength in the tourism, aerospace, biosciences/healthcare, education, financial services, construction, and manufacturing sectors. As the seventh largest City in the United States, it has solidified its position as a location that can support mission critical information technology firms, security companies, and large data centers.

New employment opportunities that have risen from economic development have helped stimulate the San Antonio market. Expansion in the northern part of the City has been on-going for some time, and growth in the western suburbs of the City is continuing. New growth is also projected to occur to the south, which is a relatively new direction for major development in San Antonio. As a result, CPS Energy is not predicting net customer losses in fiscal year (FY) 2012.

FORECAST OF CUSTOMER REQUIREMENTS

The CPS Energy planning process begins with the development of the Customer Requirements Forecast, which is a projection of the number of customers and their energy consumption. The forecast is based on weather-normalized, historic sales, adjusted for the effect of its energy efficiency and conservation programs, such as the Save for Tomorrow Energy Plan (STEP) Program. The development of this forecast is a complex process involving the assessment of various economic, demographic and technological factors. The forecast is the basis for planning decisions regarding the future growth and operation of the electric and gas systems and for the determination of the revenues required to finance that growth. The most recent summary forecast of Customer Requirements was prepared during the summer of calendar year 2010.

Electric system customer accounts totaled 717,109 on December 31, 2010, and are estimated to be at 744,769 on January 31, 2012, for an increase of 27,660 customer accounts, or 3.9%.

Gas system customer accounts totaled 324,634 on December 31, 2010, and are estimated to be at 325,337 on January 31, 2012, for an increase of 703 customers, or 0.2%.



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FINANCING PLAN AND REVENUE REQUIREMENTS

Total Gross Revenue is estimated at \$2,211 million for Fiscal Year (FY) 2012 with Operating Revenue projected at \$2,180 million. Total Gross Revenue will be used to fund Operating Expenses, Debt Services (principle and interest), City Payment and part of the Capital Budget (also referred to as the Repair and Replacement Account (R&R)). For FY 2012, the total O&M budget of \$1,358 million will be funded with 61% of the Gross Revenue. Debt Requirements and City Payment have been estimated at \$391 million and \$277 million, respectively, and will be funded with 18% and 13% of the Gross Revenue, respectively. The remaining \$185 million (\$133 million at 6% of revenues plus a \$52 million residual), or 8% of Total Gross Revenue, will be available for partially funding the Capital Budget for FY 2012.

The current plan is to fund next year's capital budget with \$265 million debt, \$221 million from the R&R Account and \$22 million from third-party Contributed Capital. (Also see Figure 3 of the Charts section.)

In March 2010, CPS Energy issued \$380 million of new money bonds, which after paying for costs of issuance, left \$377 million of bond proceeds available to fund construction through FY 2011. In November 2010, CPS Energy issued an additional \$300 million of new money bonds, which provided \$298 million of bond proceeds after paying for costs of issuance. CPS Energy also refunded \$200 million of its outstanding Tax Exempt Commercial Paper (TECP) program. Combined, these proceeds are projected to fund construction through March of 2012, at which time CPS Energy will use existing TECP capacity to continue funding construction. Proceeds from all sources, including interest earned, will be primarily used to fund electric transmission, electric distribution, generation, and gas distribution construction projects.

Revenue Requirements <i>(\$ In millions)</i>		
	FY 2012 Budget	% of Revenue
Revenue	\$2,211	100%
Operating Expenses:		
Electric Fuel & Renewables/Purchased Power	\$622	28%
Distribution Gas	128	6%
PUCT and ERCOT Assessments	52	2%
CPS Energy Non-Fuel O&M	388	17%
STP Non-Fuel O&M	168	8%
Total Operating Expenses	\$1,358	61%
Debt Service	\$391	18%
City Payment	\$277	13%
Available for Construction (R&R)	\$185	8%

Debt <i>(\$ in millions)</i>	
Total Debt	\$4,882
Debt to Equity Ratio	59%
Planned Capital	
New Money Debt issues (Excluding solar considerations)	\$0
Planned AFUDC (Capitalized Interest)	\$24
Estimated Long Term Borrowing Rate	5.25%



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OPERATING & MAINTENANCE BUDGET

O&M is comprised of five major categories: Electric Fuel and Purchased Power, Distribution Gas, Public Utility Commission of Texas (PUCT) and Electric Reliability Council of Texas (ERCOT) Assessments, CPS Energy Non-fuel O&M and South Texas Project (STP) Non-fuel O&M.

Actual O&M costs for FY 2011 are estimated at \$1,206 million, or \$16 million above the approved FY 2011 budget. Electric Fuel and Purchased Power is expected to be \$46 million above budget, while Distribution Gas is expected to be \$3 million below the approved level. PUCT and ERCOT Assessments are expected to be \$13 million under the approved budget. CPS Energy's Non-fuel O&M is also expected to be \$13 million below the approved budget and STP Non-fuel O&M is expected to be \$1 million below budget.

The O&M budget for FY 2012 is \$1,358 million, which is \$152 million, or 13%, above the expected level for FY 2011 (see Figure 1). Electric Fuel and Purchased Power is projected to increase \$81 million. Distribution Gas is projected to increase \$4 million. PUCT and ERCOT Assessments are projected to increase \$12 million. CPS Energy Non-fuel O&M is projected to increase \$33 million, and STP Non-fuel O&M is projected to increase \$22 million.

While movement in O&M between FY 2011 and FY 2012 has occurred, total O&M spend will be managed within the 2-Year Rate Plan target.

The composition of the FY 2012 budget is as follows:

<i>(\$ in millions)</i>	FY 2012 Budget	% of Operating Budget	% of Estimated Revenues
Electric Fuel & Renewables/Purchased Power	\$622	46%	28%
Distribution Gas	128	9%	6%
PUCT and ERCOT Assessments	52	4%	2%
CPS Energy Non-Fuel O&M	388	29%	17%
STP Non-Fuel O&M	168	12%	8%
Total Company	\$1,358	100%	61%

Each of these cost categories is discussed in detail in the following section.



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ELECTRIC FUEL AND PURCHASED POWER

CPS Energy has a very diverse fuel mix with 20 electric generating units, four of which are coal-fired (2,206 MW) and 16 of which are gas-fired (2,776 MW). CPS Energy also has a 40% interest in STP Unit 1&2 nuclear generating units (1,080 MW). As of calendar year 2011, CPS Energy has contracted for 859 MW of wind power, 14 MW of solar power and 9.6 MW of landfill gas-generated energy, under which power is being received. CPS Energy has also contracted for 30 MW of solar power - potentially from multiple local sites - that is expected to be available in late FY 2013. To reach its goal of 1,500 MW of renewable energy, with up to 100 MW of that amount being solar power, CPS Energy announced another 50 MW solar Request for Proposal (RFP) that will include critical aspects of economic development and education.

Electric Fuel and Purchased Power reflects the costs of the various fuels used to generate electricity and the costs associated with purchased power. Costs in this category are a function of the level of electric sales, unit fuel costs and the mix of the various fuels used to generate electricity and purchased power costs, which includes wind.

Under the latest estimate for FY 2011, Electric Fuel and Purchased Power of \$541 million is estimated to be \$46 million, or 9%, above the approved budget. The variance is primarily due to higher than planned sales volumes and increases in average fuel commodity costs resulting from increased renewable volumes and gas generation costs necessary during Spruce 2 precommercial operation.

For FY 2012, the Electric Fuel and Purchased Power estimates total \$622 million, \$81 million above the FY 2011 expected level. The variance is primarily due to increased generation from Spruce 2. In addition, the FY 2012 budget includes \$8 million for higher fuel costs related to low-sulfur coal that will be utilized to reduce emissions.

DISTRIBUTION GAS

CPS Energy procures its gas supply for use in electric generation, as well as distribution to gas customers. CPS Energy receives natural gas through several major gas delivery stations, which supply gas into CPS Energy owned and operated gas transmission pipelines, or directly into CPS Energy's gas distribution system. The gas delivery stations and gas transmission pipelines are monitored and managed through a supervisory control and data acquisition (SCADA) system.

CPS Energy manages combined natural gas supply requirements for power plants and distribution systems through a diversified portfolio of firm and interruptible services with various pipelines and suppliers. In accordance with its Fuels Management Procedures, CPS Energy has negotiated competitive, enabling contracts with gas suppliers under which CPS Energy can purchase gas on a daily, weekly, monthly or seasonal basis. These supply agreements were implemented along with contracts that form a beneficial matrix of supply, transportation and storage costs.



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Policy permits staff of the Energy Supply Fuels & Hedging Division to enter into gas supply transactions for periods not exceeding one year under enabling agreements. Transactions exceeding one year must be approved by the SVP of Energy Development. The Board of Trustees must approve any fuel purchase that is for a period greater than one year and which represents more than 10% of CPS Energy's anticipated fuel purchases for the period. In addition, the Board of Trustees has approved an Energy Price Risk Management Policy, which provides formal guidelines for the purchase and sale of certain financial instruments and certain physical products, collectively defined as hedge instruments.

In FY 2008, CPS Energy received approval from the Board of Trustees to enter into a 20-year gas purchase agreement with the San Antonio Energy Acquisition Public Facility Corporation (SAEA), a Section 303 public facility corporation established by the City of San Antonio in April 2007. J. Aron, the commodity subsidiary of Goldman Sachs, supplies gas under the agreement, which represents approximately 30% of its distribution gas system requirements at a significant discount to the index price. The savings in this transaction are passed through to CPS Energy distribution gas customers. This highly structured deal involves multiple counterparties. While some entities have experienced unfavorable ratings changes, the counterparties continue to perform. CPS Energy's staff continues to closely monitor this transaction.

Distribution Gas is estimated to be \$124 million for FY 2011, which is \$3 million below the approved level. The decrease in Distribution Gas is due to a lower cost per MMBtu.

For FY 2012, Distribution Gas has been estimated at \$128 million. The increase of \$4 million is due to an increase of distribution gas cost per MMBtu projected in FY 2012.

PUCT AND ERCOT ASSESSMENTS

Effective March 2000, a regulatory adjustment factor resulting from changes in the Texas electric utility industry was added to CPS Energy's electric bills. This adjustment is comprised of two major components:

- 1) The net PUCT transmission deficit that results from the wholesale transmission pricing mechanism, and
- 2) ERCOT charges related to the operation of the Independent System Operator and various market-related costs and credits.

ERCOT is the independent entity that administers the flow of electricity on the interconnected grid that operates wholly within Texas.

Under the current plan, the assessments for FY 2011 are expected to total \$40 million, \$13 million below the approved level, due to reduced balancing energy adjustments that include lower than planned ERCOT and North American Electric Reliability Council (NERC) fees.

For FY 2012, this category has been estimated at \$52 million. This is an increase of \$12 million, or 30% over the FY 2011 expected level. The increase is due to higher Transmission Cost of Service (TCOS) resulting from higher CPS Energy load and ERCOT access fees. Additionally, ERCOT/NERC fees are expected to be higher due to fees related to the implementation of the new nodal market.



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CPS ENERGY NON-FUEL OPERATING & MAINTENANCE

CPS Energy remains focused on implementing a company-wide strategy to achieve excellence. The corporate strategy emphasizes a balance between effectively running the business to provide safe, reliable and low-cost energy for its customers, and fostering an environment that promotes an engaged workforce. In addition, the strategy centers attention on promoting sustainability and positioning the Company for future opportunities while continuing to provide returns to the City of San Antonio.

CPS Energy Non-fuel O&M for FY 2011 is expected to end the year at \$355 million, which is \$13 million below the approved budget. The variance is driven primarily by lower than anticipated expenses in outside services, which includes contractor, consulting and other professional fees.

For FY 2012, this category is estimated at \$388 million, an increase of \$33 million, or 9% from the FY 2011 expected levels. The major drivers for the increase include higher labor-related costs, power plant maintenance, conservation initiatives and services associated with maintaining the reliability of the transmission and distribution systems that support a growing customer base. The Company remains committed to not exceeding its FY 2012 targets.

STP NON-FUEL OPERATING & MAINTENANCE

CPS Energy owns 40% of Units 1&2 at the STP nuclear power plant. Since November 1997, Units 1&2 have been operated by the STP Nuclear Operating Company (STPNOC) a nonprofit Texas corporation financed and controlled by the owners of the plant, pursuant to an operating agreement and a participation agreement. All costs and output continue to be shared in proportion to ownership interests. STPNOC is committed to operational and financial excellence by achieving top decile rankings among all of the commercial nuclear plants in the nation in the categories of incremental cost, forced loss rate and capability factor.

Units 1&2 Non-fuel O&M expenses for FY 2011 are expected to be \$146 million, which is \$1 million below the approved budget. The variance is primarily due to STPNOC receiving a credit based on the resolution of a commercial issue with a vendor and they did not make the planned quarterly accrual for the incentive plan as the outlook for incentive plan payouts was reduced due to forced outages.

For FY 2012, this category has been estimated at \$168 million. This amount is \$22 million above the expected costs for FY 2011 as a result of two refueling outages, compared to only one outage in FY 2011, and compliance costs for new regulatory requirements.



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CAPITAL BUDGET

Planning for current and future electric generation, electric transmission and distribution, gas system capital construction programs, and supporting technology and facilities is an on-going process. Given the long-term and high-cost nature of utility assets, the CPS Energy capital planning process is designed to focus on optimizing the returns on investments in capital assets. CPS Energy develops capital plans at four levels:

- A 35-year electric resource plan that projects specific electrical power generation alternatives.
- A 15-year Long-Range Transmission and Substation Development Plan that estimates the transmission requirements for the CPS Energy service area.
- A 10-year projection of the capital budget, to ensure proper integration with the Strategic Plan initiatives and targets.
- The current year plan to meet immediate growth and modernization needs.

CAPITAL SUMMARY

Capital expenditures for FY 2011 are estimated at \$448 million and are \$75 million under the approved plan. The key drivers for this variance include \$38 million deferred spend to FY 2012, in Energy Supply, in addition to \$25 million attributed to savings and lower than expected customer growth.

The Capital Budget for FY 2012 of \$508 million is \$60 million above the expected level for FY 2011. Energy Supply accounts for the majority of the increase due to the \$38 million deferral from FY 2011 (see Figure 2).

The composition of the FY 2012 Capital budget is presented to the right.

Each of these categories is discussed on the following pages.

	<u>\$ Million</u>	<u>% of Budget</u>
Electric Distribution	\$160	31%
Electric Transmission	50	10%
Subtotal EDS	210	41%
Energy Supply	200	40%
Gas Distribution	30	6%
Retail	10	2%
Enterprise Services*	58	11%
Total Company	\$508	100%

* Primarily includes spend for Audit Services, Corporate Support Services, External Government Relations, Financial Services, General Counsel, President & CEO and Sustainable Growth Office.



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ELECTRIC DISTRIBUTION

CPS Energy's electric distribution system is the pathway for the delivery of energy from the transmission lines and substations to the customers. System additions are strategically planned to keep pace with the anticipated expansion of the San Antonio Metropolitan area, and growth in customer demands for energy. This budget category consists of costs associated with serving new subdivisions and individual customers, distribution system expansion and growth, infrastructure modernization and civic improvement projects requested by the State, County and the various cities served by CPS Energy.

Electric Distribution capital expenditures of \$151 million for FY 2011 are estimated to be \$12 million under the approved plan. The primary drivers for the variance include vehicle replacement/purchases delays and slower customer growth.

Electric Distribution capital expenditures of \$160 million are included in the budget for FY 2012; \$9 million above the FY 2011 expected results. The increase is attributable to improvements in customer growth and infrastructure modernization. These projects include Underground Residential Distribution (URD) cable replacements and circuit upgrades to help improve reliability.

ELECTRIC TRANSMISSION

CPS Energy's transmission line network represents the path for moving electric power from the generating plants to substations within the service area, and to and from other utilities, as required. This budget category is comprised of both new additions to the transmission system and civic improvements.

Electric Transmission capital expenditures of \$50 million are estimated to be \$6 million above the approved plan. The increase is the result of spend related to right-of-way clearance to ensure transmission lines are within acceptable clearance levels, various projects that were deferred from FY 2010 and a few projects that were moved forward from FY 2012.

For FY 2012, Electric Transmission capital expenditures are estimated at \$50 million consistent with the FY 2011 spend.

ENERGY SUPPLY

The Energy Supply category consists of capital expenditures required for the following:

- 1) Power plant improvements to improve safety, reliability, environmental stewardship and operating efficiencies;
- 2) Compliance with State and Federal regulations; and
- 3) Projects related to STP Units 1&2.



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Energy Supply capital expenditures for FY 2011 are projected to be \$184 million, which is \$57 million under the FY 2011 approved budget. The decrease is primarily due to deferred spend related to Spruce 2 and a claim mitigation that did not materialize.

CPS Energy's Board of Trustees approved a negotiated settlement with the other STP Units 3&4 co-owners. The settlement resulted in CPS Energy retaining a 7.625% interest in the project that requires no further expenditures for construction. However, professional services and internal costs, primarily labor, will be required to monitor and protect its investment.

For FY 2012, Energy Supply capital expenditures have been estimated at \$200 million or \$16 million above the expected level for FY 2011. The primary drivers of the increase are the deferral of \$38 million from FY 2011 to FY 2012 for Spruce 2. The total budget for FY 2012 includes a \$70 million renewable project. This renewable project is an addition as a result of the deferral of the Deely Scrubbers. Also included in FY 2012 is approximately \$675 thousand in costs related to STP Units 3&4.

GAS DISTRIBUTION

CPS Energy's gas distribution system is the path of moving purchased natural gas to retail customers. This category is comprised of customer extensions, system expansion, infrastructure modernization, and civic improvements.

FY 2011 Gas Distribution capital expenditures of \$23 million are estimated to be \$5 million below the approved plan as a result of deferring supply main projects.

For FY 2012, Gas Distribution has been estimated at \$30 million or \$7 million over the expected results for the FY 2011. The increase is primarily the result of the delay of supply main projects to FY 2012 and an increase in civic improvement projects.

RETAIL

The CPS Energy Retail business consists of customer service, customer billing & collections, customer relations and economic development. Capital expenditures within Retail are comprised of projects that enhance customer care through telephone contact, electronic billing and payment improvements and enhanced web based customer tools.

FY 2011 Retail capital expenditures of \$1 million are estimated to be \$3 million below the approved plan. The decrease is primarily related to the initial spend on the Customer Relationship Management (CRM) billing system enhancement, which is being deferred to FY 2012.

For FY 2012, Retail capital expenditures have been estimated at \$10 million or \$9 million over the expected results for the FY 2011. The increase is primarily due to the CRM project deferral to FY 2012, which represents \$7 million of their FY 2012 budget.



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ENTERPRISE SERVICES

Enterprise Services consists of Audit Services, Corporate Support Services (CSS), External Government Relations, Financial Services, General Counsel, President& CEO and the Sustainable Growth Office. The Sustainable Growth Office is overseeing several projects, such as Advanced Metering Infrastructure and Master Data Management (AMI/MDM), research and technology, and environmental which make up the largest portion of the Enterprise Services capital budget followed by infrastructure modernization projects in the Information and Communications sections of CSS.

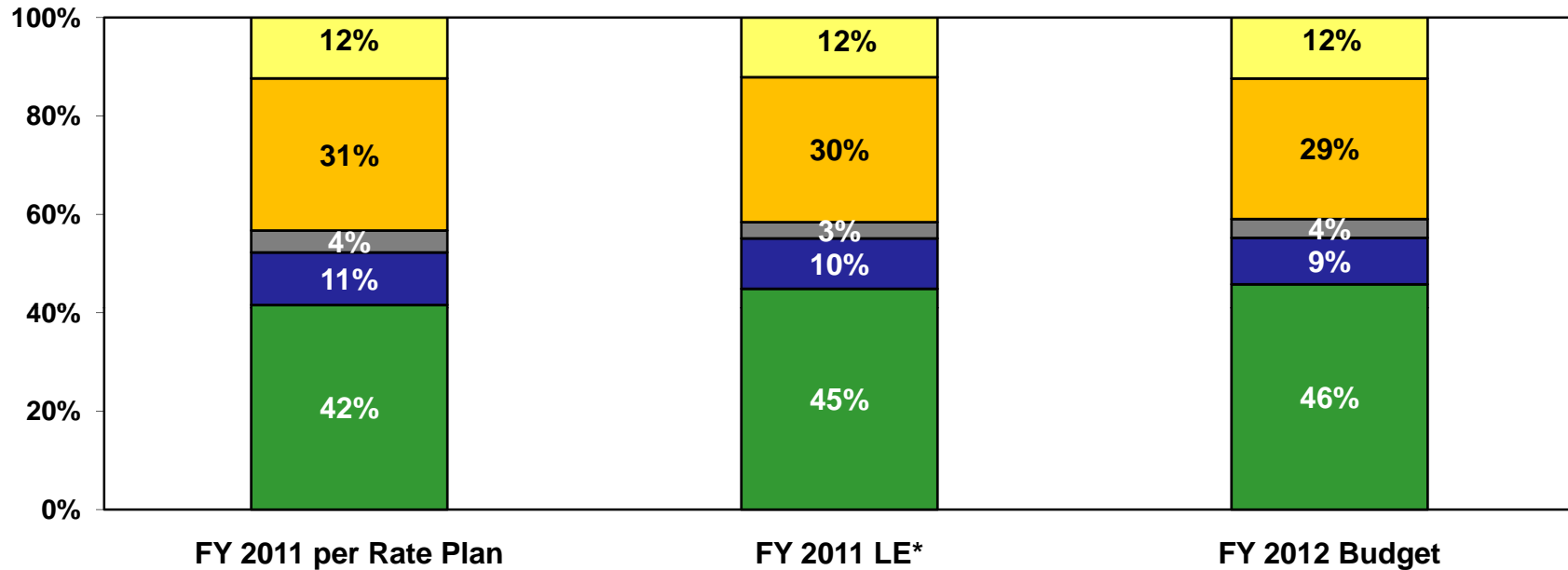
FY 2011 Enterprise Services capital expenditures of \$39 million are estimated to be \$4 million below the approved plan. The decrease is primarily due to delays in the (AMI/MDM) project, Harmony radio system, information technology server infrastructure, and security projects.

This category has been estimated at \$58 million for FY 2012, \$19 million above the expected level for FY 2011. The increase is the result of the delay in several projects including the AMI/MDM, Harmony project and infrastructure server projects to FY 2012.



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Operating & Maintenance Budget



■ Electric Fuel & Purchased Power
 ■ Distribution Gas
 ■ PUCT and ERCOT
 ■ CPS Energy Non-fuel O&M
 ■ STP Non-fuel O&M

(\$ millions)	FY 2011 Rate Plan	FY 2011 LE*	FY 2012 Rate Plan
Electric Fuel & Purchased Power**	\$495	\$541	\$622
Distribution Gas	127	124	128
PUCT and ERCOT	53	40	52
CPS Energy Non-fuel O&M	368	355	388
STP Non-fuel O&M***	147	146	168
Total	\$1,190	\$1,206	\$1,358

* Forecast based on 11 months actuals and 1 month estimate.

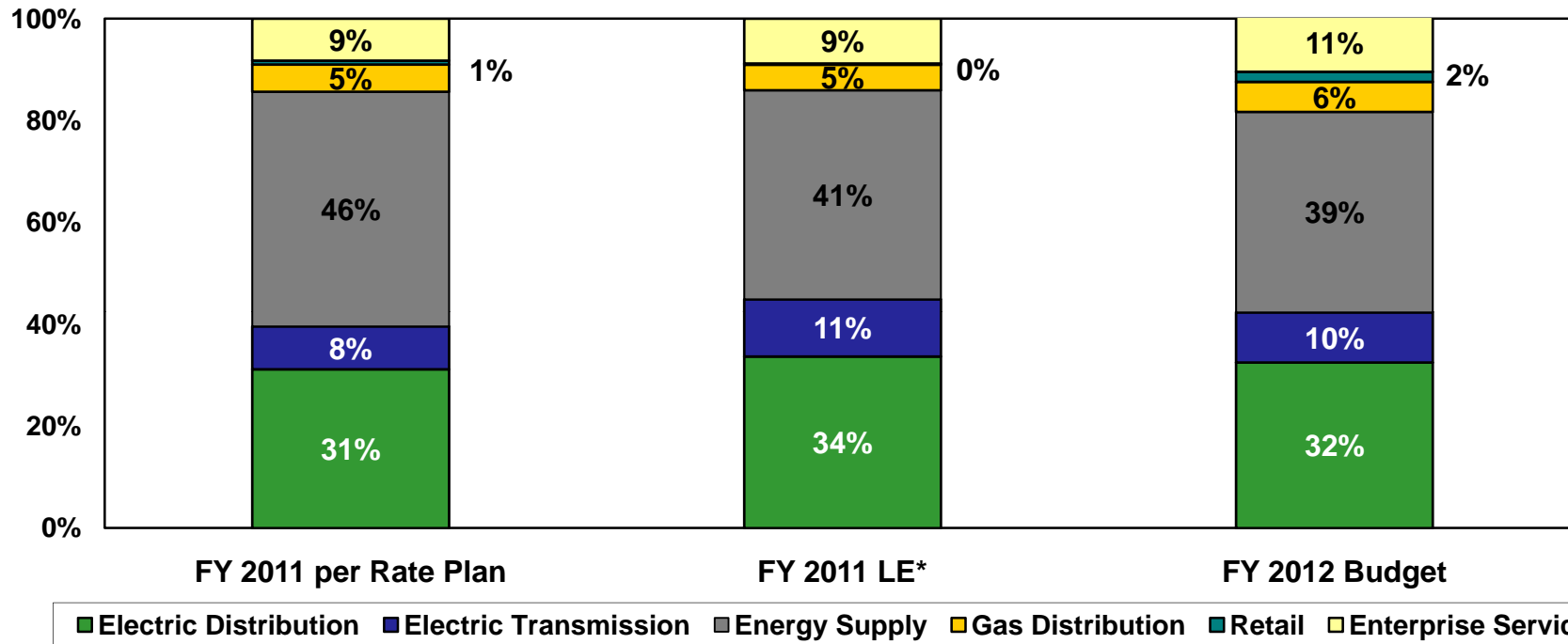
** Includes STEP expenses.

*** Includes Decommissioning.

Figure 1



Capital Budget by Major Functional Categories



(\$ millions)	FY 2011 Budget	FY 2011 LE*	FY 2012 Budget
Electric Distribution	\$163	\$151	\$160
Electric Transmission	44	50	50
Energy Supply	241	184	200
Gas Distribution	28	23	30
Retail	4	1	10
Enterprise Services and other	43	39	58
Total	\$523	\$448	\$508

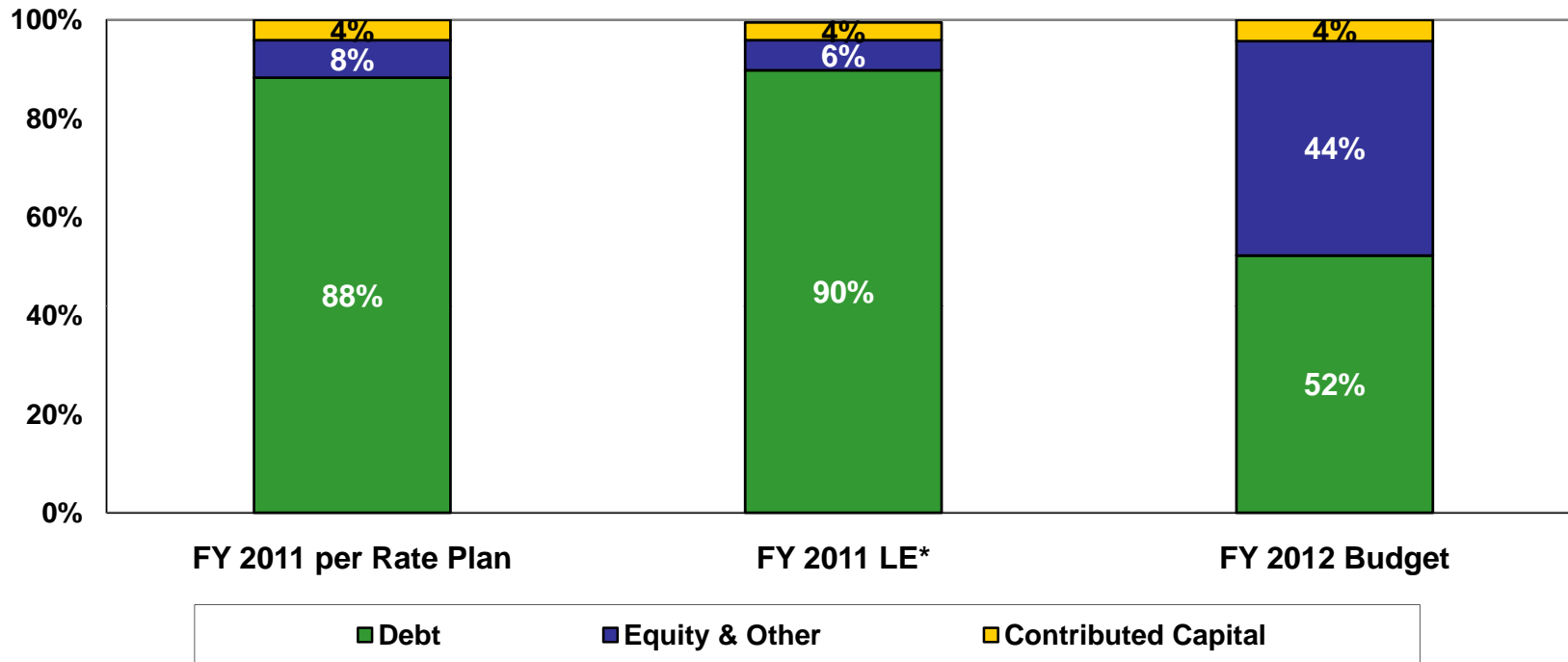
*Based on 11 months of actuals and 1 month estimate.

Figure 2



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Construction Funding



<i>(in millions)</i>	FY 2011 Budget	FY 2011 LE*	FY 2012 Budget
Debt	\$462	\$402	\$265
Equity & Other	40	30	221
Contributed Capital	21	16	22
Total	\$523	\$448	\$508

* Based on 11 months of actuals and one month estimate.

Figure 3



Financial Ratios

Ratio	FY 2011 Rate Plan	FY 2011 LE	FY 2012 Rate Plan	FY 2012 Budget
Debt to Equity Ratio (%)	61.0%	60.3%	61.0%	59.0%
Debt Service Coverage Ratio - Total coverage after City payment (Times)	1.43x	1.64x	1.41x	1.47x

Includes all debt, including Tax Exempt Commercial Paper and Flexible Rate Revolving Note Program (FRRN).

Figure 4