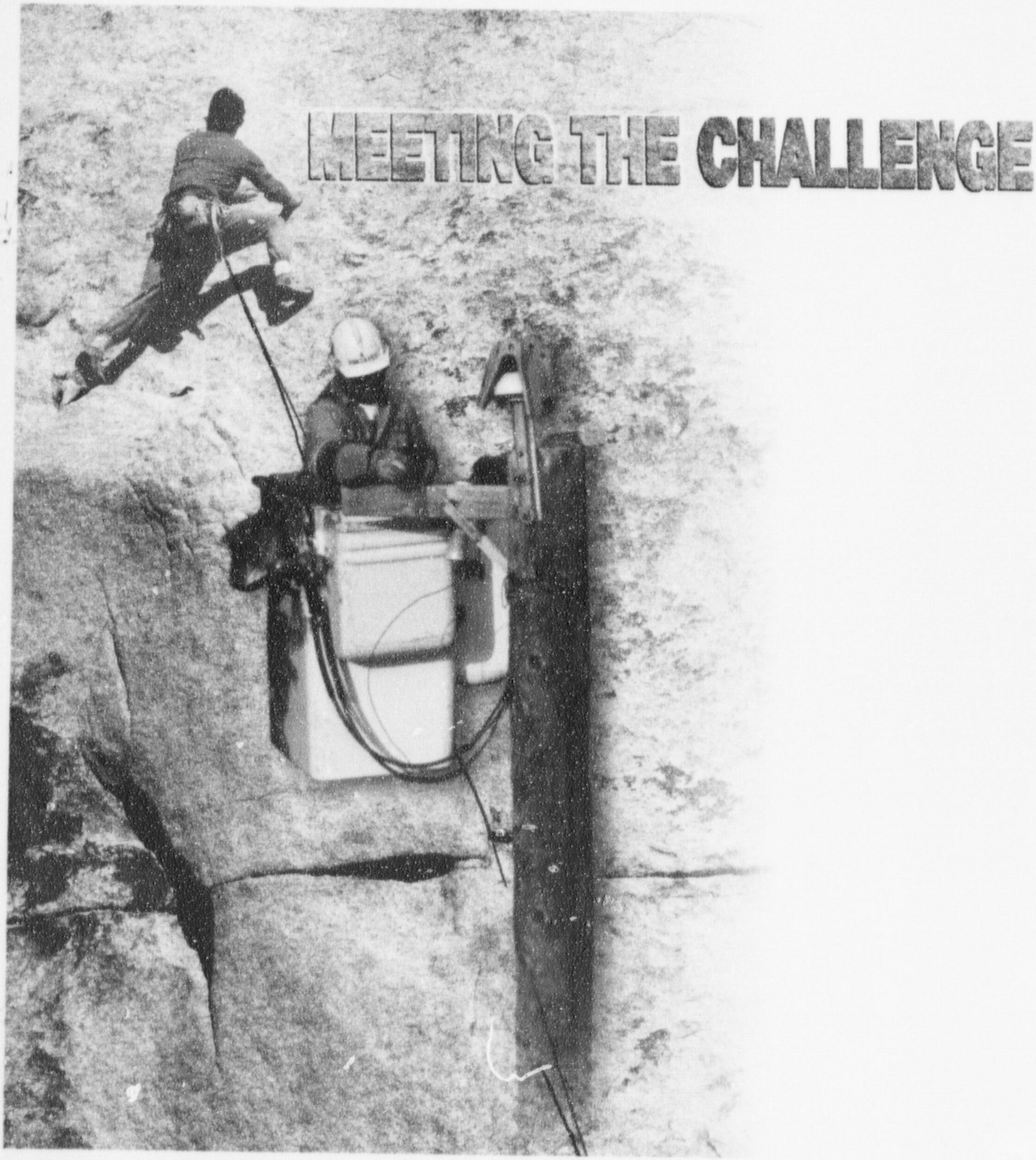

CITY PUBLIC SERVICE OF SAN ANTONIO
1997 - 1998 ANNUAL REPORT

SIGNIFICANT FACTS FOR THE YEAR

• Gross revenue increased $7,887,000 to	$1,032,202,000
• Fuel and operating and maintenance expenses increased $1,610,000 to	$489,962,000
• City payment increased $955,000 to	$138,543,000
• Long-term principal and interest requirements on bonds decreased $23,465,000 to	$193,835,000
• Maximum electric system load increased 92,000KW to	3,448,000 KW
• 10,661 electric customers were added to total	539,400
• KWH sales decreased less than 1% to	15,167,815,507 KWH
• Cost to residential customer per KWH	6.56¢
• 996 gas customers were added to total	301,181
• MCF sales decreased less than 0.1% to	26,775,033 MCF
• Cost to residential customer per MCF	$5.86

SUMMARY FOR 1997-98 ($000s)

Gross revenue	$1,032,202
Application of gross revenue:	
Fuel, purchased power, and resale gas costs	$256,836
Other operating and general costs	157,291
Maintenance costs	75,835
Regulatory transition assessment	1,851
New series bonds debt service and reserve requirements	186,244
Commercial paper debt service	15,841
Repair and replacement account - 6% of gross revenue	61,932
Payments to the City's General Fund	138,543
Other interest and debt expense	1,190
Repair and replacement account - remaining deposit	136,639
Total	$1,032,202

Additions to plant and net removal costs	$204,200
Funding for expenditures:	
Bond proceeds	$152,753
Revenue from operations	39,555
Commercial paper proceeds	4,500
Customer contributions and other proceeds	7,392
Total funding	$204,200

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Profile of San Antonio's Gas and Electric Utility

City Public Service (CPS) has what it takes to meet the challenges each day in providing excellent utility services. The company's well conditioned team members call on their skills and knowledge to perform at superior levels.

One of the nation's largest municipal utilities, CPS serves more than 539,000 electric customers throughout its 1,566 square mile service area, and about 301,000 natural gas customers in the urban San Antonio area. Purchased in 1942 by the City of San Antonio, CPS provides reliable, low-cost energy and energy-related services for San Antonio and the surrounding area, making San Antonio an ideal place to live and conduct business.

CPS owns and operates two coal-fired and five natural gas-fired power plants in the San Antonio area, and owns 28 percent of the South Texas Project nuclear plant on the Gulf Coast. The natural gas system has 4,158 miles of lines through which natural gas is delivered.

A diversified fuel mix at favorable prices, low production costs and sound financial management have enabled CPS to keep its rates lower than any major Texas city, and among the lowest in the nation. The average CPS residential gas and electric bill ranked third-lowest among the 20 largest cities in the United States for fiscal year 1997-98. The utility's favorable bond ratings assure lower interest rates when CPS requires financing for large projects.

CPS returns a percentage of its revenues to the City of San Antonio and since its formation has contributed more than $2.2 billion. The $138.5 million CPS payment for the 1997-98 fiscal year represented the largest source of income for the City of San Antonio and about one-third of the City's general fund revenue.

CPS also supports the community through education, employee volunteerism and donations. Free tours and informative programs teach participants about the utility, gas and electric safety and energy conservation. Under the Volunteers in Public Service program, CPS employees donated more than 14,000 hours and raised more than $17,000 for nonprofit organizations in 1997-98. More than 85 percent of the active work force and 100 CPS retirees contributed to United Way, giving more than $500,000 in the recent campaign.

Low rates, reliable service and a dedicated work force make City Public Service a leader in the utility industry and a vital driving force in San Antonio.

Letter From The Chairman and General Manager

City Public Service experienced another year of successes in 1997-98. The utility achieved some financial milestones and continued its preparation for the future when customer choice is expected to bring retail competition to the electric utility industry in Texas.

Financial highlights of the year include issuing $661 million in revenue and refunding bonds. The third-largest bond issue in the utility's history took advantage of low rates to achieve interest savings which will continue to put the utility in a favorable financial position. The bond issue is part of a two-year debt management strategy that will increase the use of bond funds for routine construction while freeing cash for the utility's future needs.

Financial benefit also resulted from the first year of joint operation of the utility's generating facilities with those of Houston Lighting & Power Company. Under the joint operating agreement, CPS received $25.6 million in savings for the first year which ended June 30, 1997. By fiscal year-end, the savings for CPS totaled $32.5 million. The agreement will run for 10 years and will produce at least $150 million in savings for the utility.

Despite support from several major quarters, a bill to restructure the electric utility industry in Texas through introduction of retail competition failed in the late days of the 1997 Texas legislative session. Though uncertain if retail competition ultimately will benefit most consumers, CPS, through the Texas Public Power Association, was able to influence inclusion in the bill of several protections for municipal utilities and their customers. The CPS staff will continue to pursue such protections in legislation which is expected to be introduced in the next session, beginning January 1999. As President of the Texas Public Power Association, the CPS General Manager will play a major role in developing the municipal utility position on legislation.

The additional time before a decision on retail competition is reached will allow regulators and the industry to evaluate the changes already made in wholesale competition. Lawmakers also will be able to evaluate the experiences of other states that have approved retail competition.

To meet the challenge that will be presented by retail competition, CPS has begun a program to market new products and services to current customers. Marketing these products and services is expected to help retain customers when they have a choice among electricity providers and also to provide additional revenue to CPS. Utility staff are studying various alliances to help bring these new products and services to market, expanding the core gas and electric businesses.

As CPS embarks on another year, the utility has a solid financial foundation, modern facilities and a conscientious work force to meet the goal of providing reliable natural gas and electric services at the lowest possible price. CPS looks forward to the opportunities which lie ahead and is poised to continue providing utility service in a dynamic environment.

Frank Bryant
Chairman

Arthur von Rosenberg
General Manager

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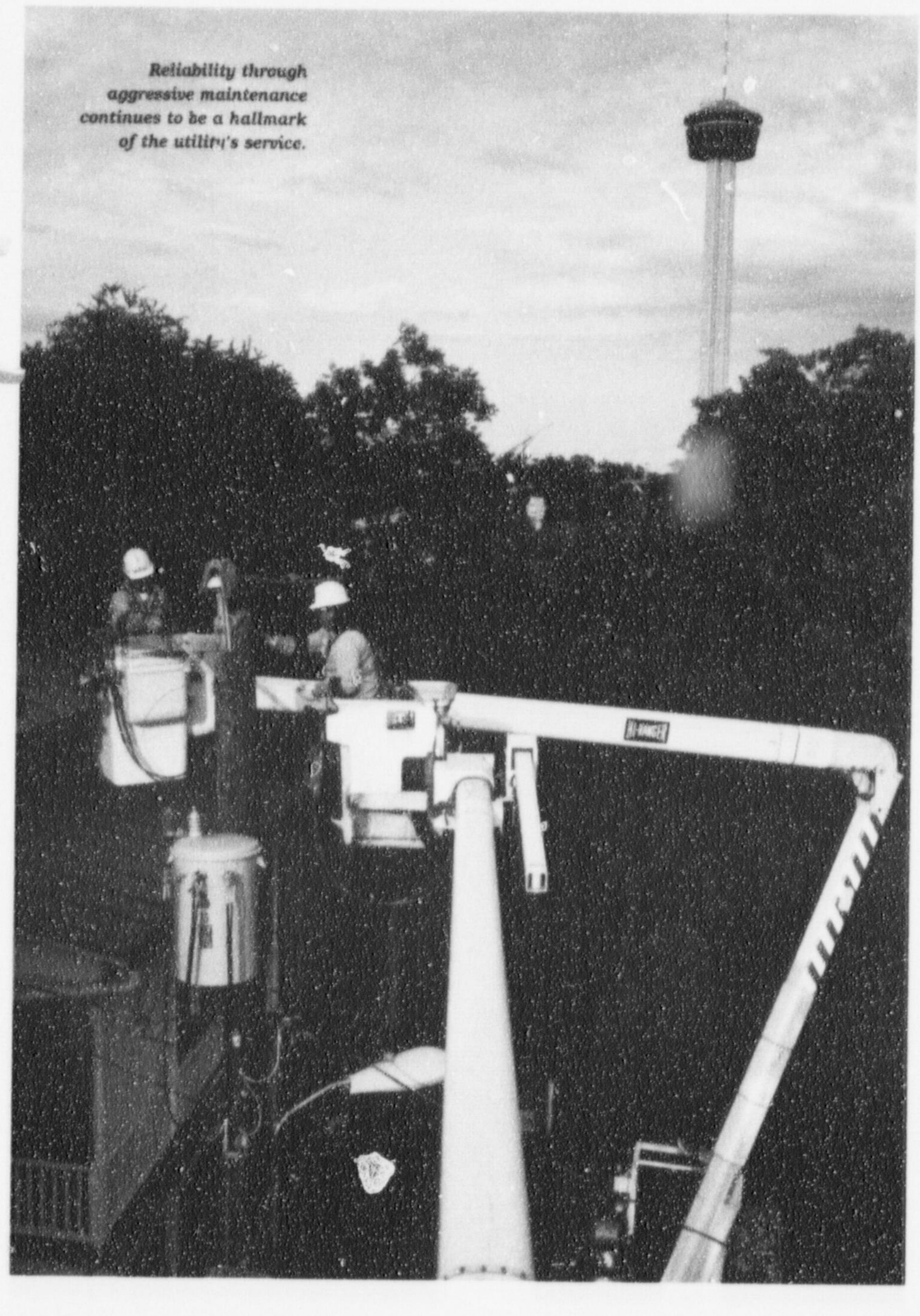
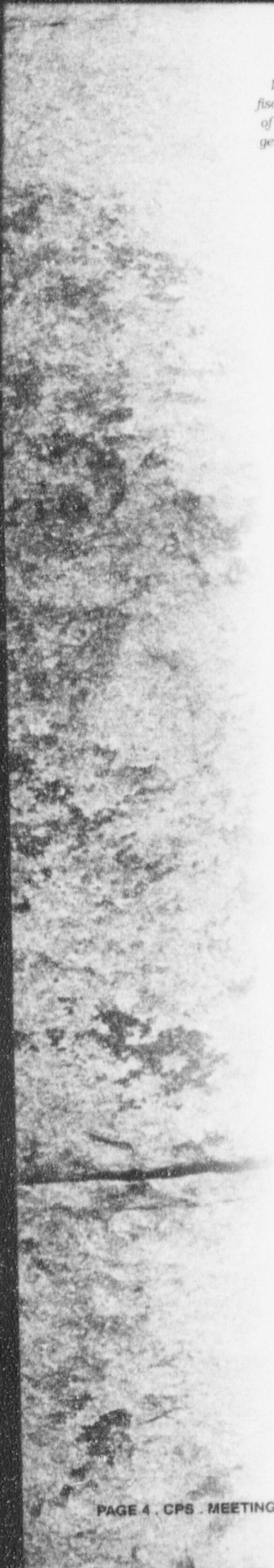
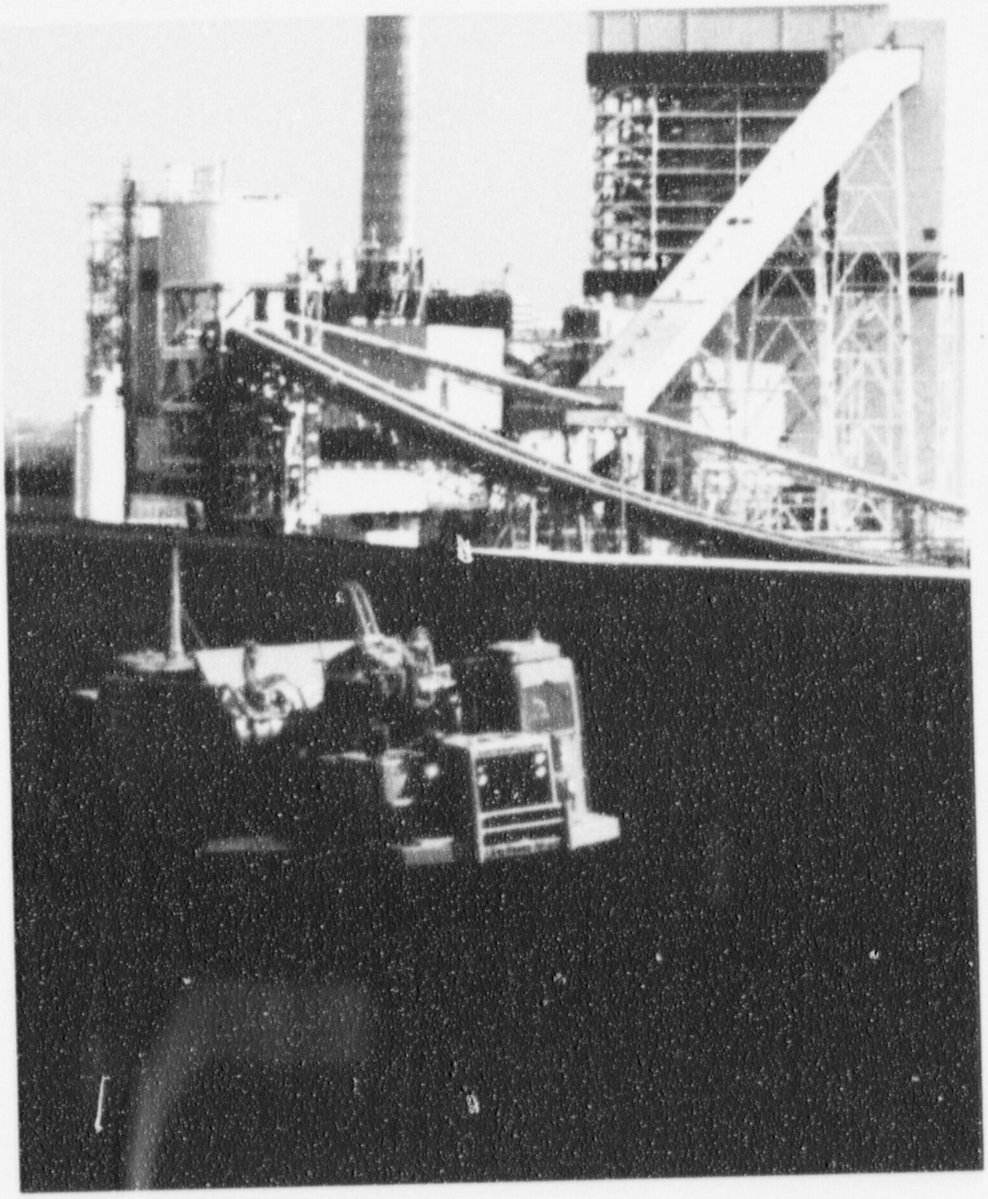
CPS CLIMBING TO A NEW LEVEL OF SERVICE



Reliability through aggressive maintenance continues to be a hallmark of the utility's service.



During the 1997-98 fiscal year, 49 percent of the utility's electric generation came from low-sulfur coal.



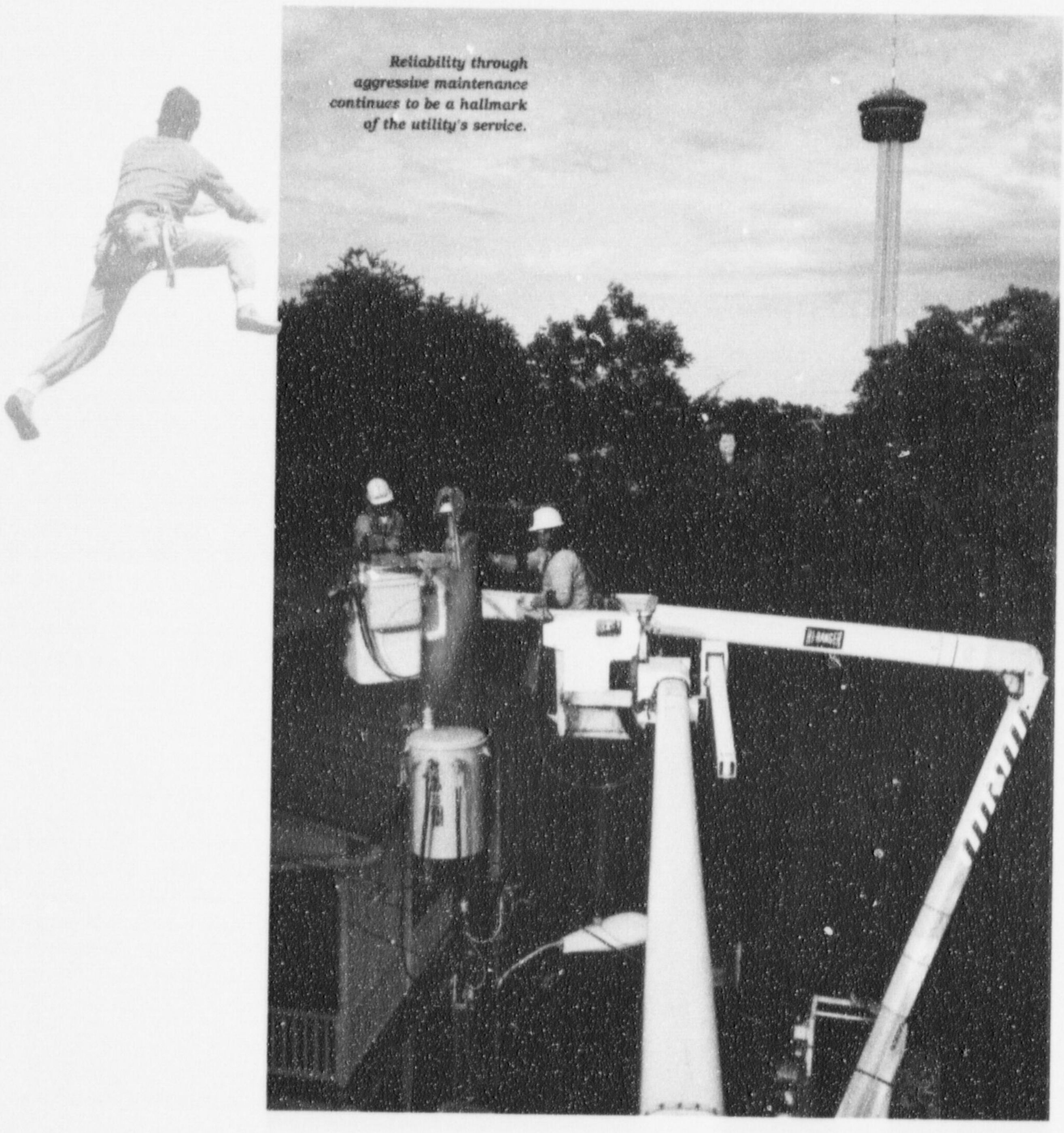
City Public Service has the energy and vitality to serve its more than 539,000 electric and 301,000 natural gas customers. With 4,515 megawatts of generating capacity and 4,158 miles of natural gas lines, the utility not only has the energy to serve its current customers but the ability to provide reliable service as growth continues.

To assure that customer service continues at the highest standard, CPS took steps during the fiscal year to maintain low rates, improve reliability and respond quickly to customer needs. These actions have served CPS and its customers well in the past and will continue to do so.

During the 1997-98 fiscal year, CPS customers paid among the lowest rates in the state and nation, rates which have not increased since February 1, 1991. The CPS residential gas and electric bill ranked third lowest among the 20 largest cities in the country. The average monthly electric bill for 1,000 kilowatts of electricity in major Texas cities during the year was $76.99, while CPS customers paid $63.94.

The amount of the average residential electric bill has decreased during the last 12 years. An independent study conducted by the Jacksonville Electric Authority reviewed residential electric costs for 1,000 kilowatt hours (KWH) of electricity

CPS CLIMBING TO A NEW LEVEL OF SERVICE



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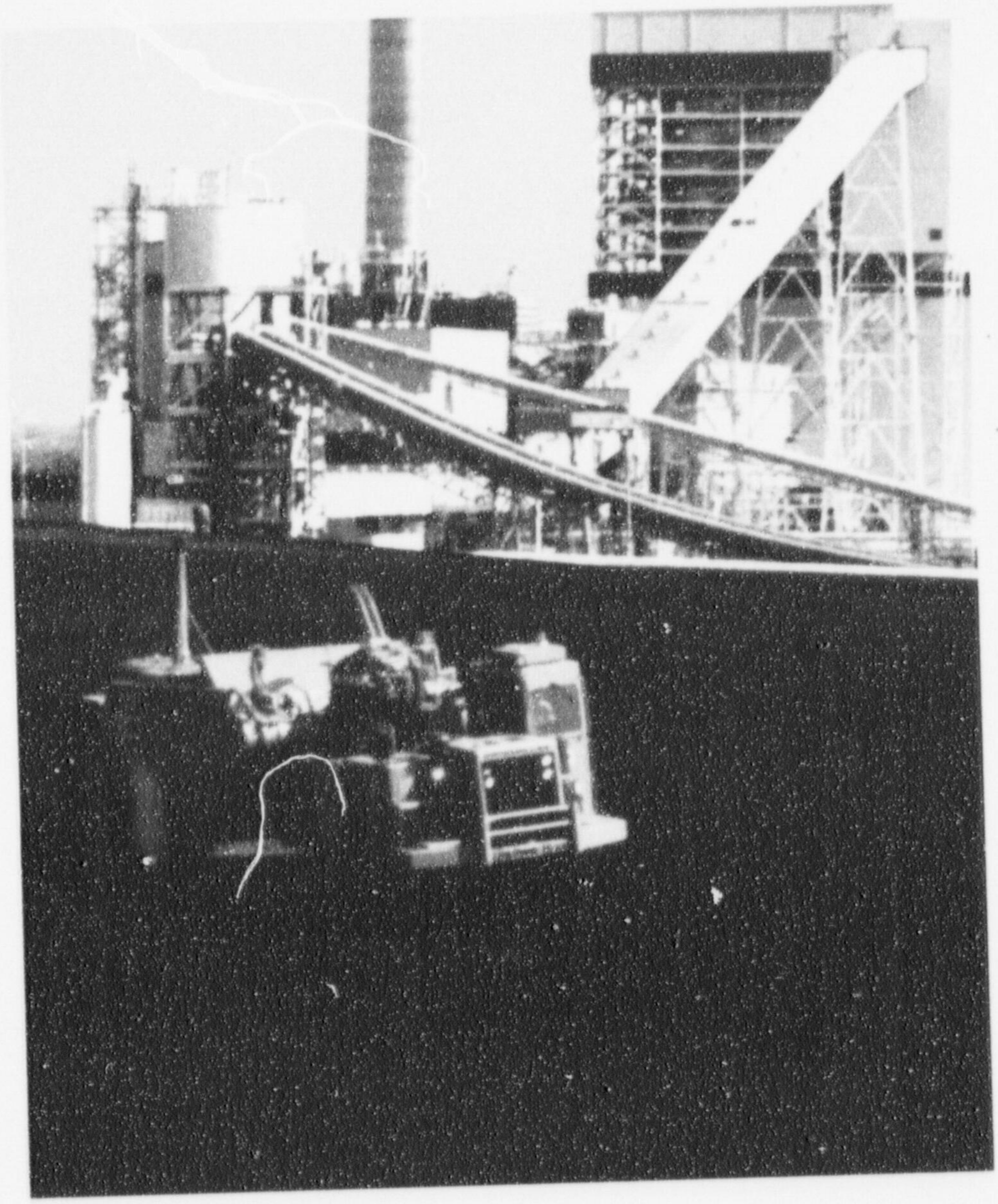

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The amount of the average residential electric bill has decreased during the last 12 years. An independent study conducted by the Jacksonville Electric Authority reviewed residential electric costs for 1,000 kilowatt hours (KWH) of electricity from 60 of the nation's investor-owned and public power utilities. CPS bills were reported to have decreased 9.68 percent for 1,000 KWH during the 12 years from 1986 through 1997.

Fuel diversification and diligent management have long been cornerstones in keeping rates low. The ability to use a diverse mixture of fuels, including nuclear fuel, natural gas and coal to generate electricity also has helped produce stable energy rates for San Antonio.

However, fuel management for the generation of electricity during the 1997-98 fiscal year was challenging, as insufficient coal deliveries from the utility's rail carrier Union Pacific Railroad plagued CPS. To make up for slow deliveries, CPS contracted with an additional rail carrier, Burlington Northern, and bought alternate fuels to reduce the use of more expensive natural gas for electricity production. CPS purchased 88,000 tons of South American coal and used petroleum coke, a by-product of oil refining, to supplement the Wyoming coal supplied through Union Pacific.

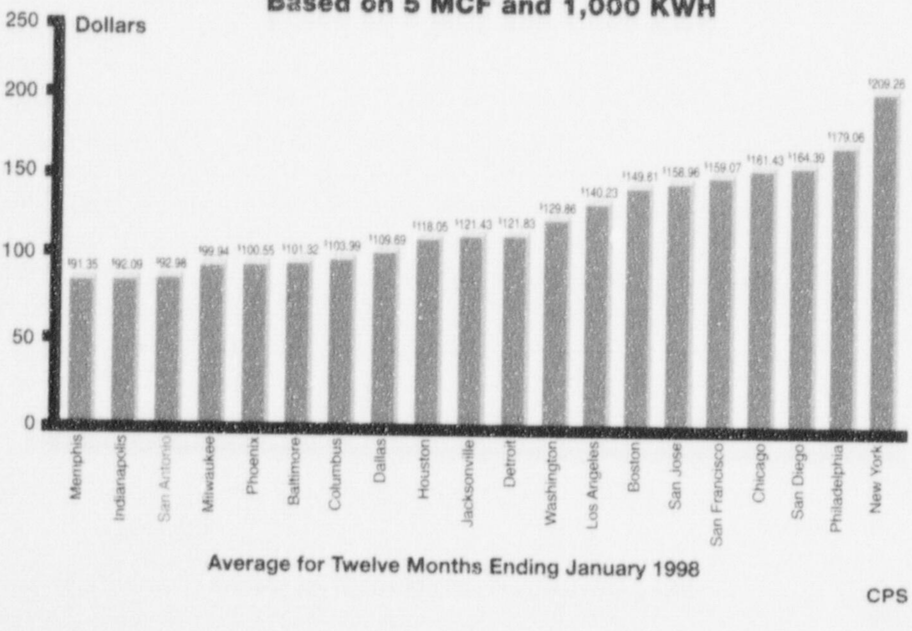
LOW PRODUCTION COSTS at the CPS power plants also are responsible for helping maintain low rates. The South Texas Project nuclear plant, located near the Texas coast, completed another successful year of operation. Unit I achieved 100.7 percent of the rated capacity while Unit 2 produced 92.9 percent of its rated capacity during calendar year 1997. The South Texas Project generated 19.85 billion net kilowatt hours of electricity, assuring it a place among the top producing nuclear plants in the country. CPS has a 28 percent share in the nuclear plant and received 35 percent of its generation from STP during 1997-98.

In a major change during the year, the owners of the nuclear plant transferred management from Houston Lighting & Power Company to the STP Nuclear Operating Company. The non-profit corporation has five officers and a five-member board of directors with one representative of each of the co-owners and one for the Operating Company. Co-owners reimburse the Operating Company for all nuclear plant costs in proportion to their ownership of the facility.

STP maintenance, plant support and plant operations received a superior ranking in the Nuclear Regulatory Commission's Systematic Assessment of Licensee Performance for the period

The South Texas Project, located on the Texas coast, was rated among the top producing nuclear plants in the country by the Nuclear Regulatory Commission.

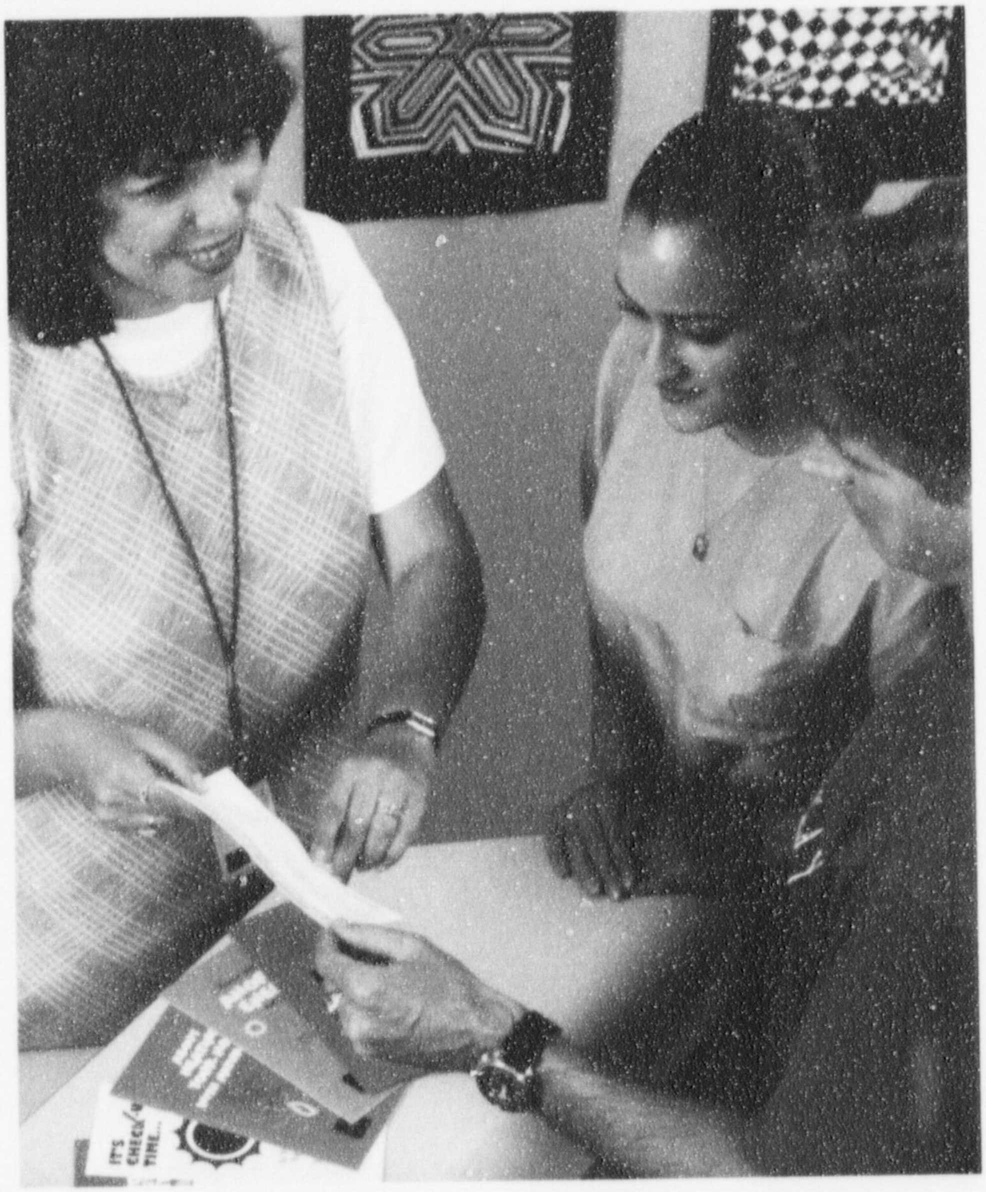
Comparison of Residential Gas and Electric Bills for the 20 Largest U.S. Cities Based on 5 MCF and 1,000 KWH



Average for Twelve Months Ending January 1998

Technicians from the General Maintenance Group prepare a power plant unit to handle the heavy summer load.

A CPS customer service representative explains to customers how to conserve energy and save on their CPS bill.



March 24, 1996, to November 15, 1997. All these factors are crucial in maintaining safety standards and keeping production costs low.

The CPS coal-fired plants also achieved low production costs. In a report prepared by the Utility Data Institute, the coal-fueled J.T. Deely and J. K. Spruce plants ranked seventeenth and twenty-fourth respectively for their 1996 production costs compared to the best performing 100 steam-electric power plants in the country. The Deely plant averaged $12.06 per net megawatt hour and the Spruce plant averaged $12.64. The two plants were the only Texas plants ranking in the top twenty-five. UDI included fuel costs in the calculation of production costs.

Efficient management of resources has a positive effect on operating costs. In a step toward greater efficiency, CPS has begun creating a more flexible work force by integrating power plant crafts. In 1997-98, the boiler crew, carpenters and insulators began cross-training and will be known as the General Maintenance Group, with the skills to do a variety of power plant work. The utility also developed a **SKILLS TRAINING EVALUATION PROGRAM** which tracks the performance progress of all apprentices and trainees.

Initiated in 1994, the program will continue until all production maintenance trainees and apprentices have achieved the journeyman level.

To allow CPS to grow in a competitive environment, the utility has taken steps to increase its efficiency through more sophisticated management controls. **A Newly-Adopted Accounting System** allows management to more closely monitor overall performance and maintain budgetary controls for the four business units. The new system provides CPS with a method to compare operational and financial results with other utilities and provides detailed information to allow in-depth analysis and reporting, as well as retrieval of information on-line.

Additionally, CPS made great strides in **Enhancing Customer Service** and better responding to customer needs while reducing costs through decentralization of gas and electric service construction requests. One-stop service centers, which began as a pilot project in 1996, provide customers a single contact for all their energy needs. Internally, the one-stop service center concept streamlines planning and execution of service work through improved coordination and communication. During the 1997-98 fiscal year, commercial and residential planners completed the move to service centers where they will be closer to customers and closer to the construction/ maintenance work force, a move designed to both reduce costs and provide excellent service.

Improved Reliability Of Service has become a top priority at CPS, leading the utility to take steps which will enhance an already enviable record. Actions to improve reliability include enhancements to the gas and electric systems and changes in the way crews respond to outages.

As part of the utility's continuing improvement program, CPS replaced 55 miles of direct-buried electric cable with cable in conduit during 1997-98. The program to replace approximately 1,360 miles of direct-buried cable will be carried out even more aggressively, with a goal of 80 miles next year and 100 miles in following years. CPS also will augment the replacement program with a pilot project of in-place cable curing, a process which improves cable performance and life more quickly and more cost effectively.

Gas system reliability was improved through the replacement of 9,152 steel gas services with polyethylene pipe in residential areas in San Antonio. Through the gas service renewal project, which began in 1995, CPS has replaced approximately 17,300 steel gas services and expects to replace 11,162 more by the end of 1998. CPS also completed approximately 40.7 percent of the $12.5 million second outer gas loop which will encircle San Antonio by the year 2000 to provide natural gas to growing parts of the city.

Another enhancement, which will increase work force flexibility and reduce the costs and duration of electric outages, is the combination of three electric distribution crafts into one job, the multi-skilled distribution journeyman. The distribution journeyman will respond to both overhead and underground electric problems, rather than serving as a specialist in one service job. The result is outages will be handled more quickly because of reduced travel time and more immediate availability of skilled labor. Cost reductions will occur through the simplification of routine work and work scheduling.

CPS is developing flexible programs to meet the needs of customers. Since December 1996, the utility has offered

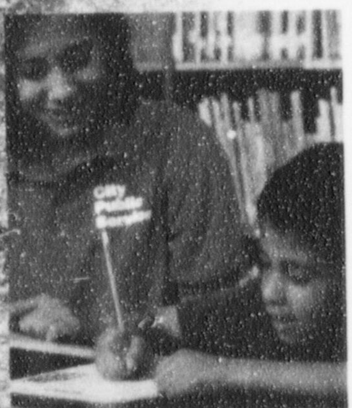
A warehouse employee inspects the padmount transformers which will be installed in neighborhoods with underground electric service.

To ensure service reliability, CPS is replacing underground electric cables throughout San Antonio.

commercial customers the option to sign long-term service agreements in exchange for the utility deferring their deposits. By the end of 1997-98, 1,763 commercial customers had signed service agreements and deferred more than $99 million in deposits. The agreements, averaging eight years, translate into a more stable customer base for CPS and allow the commercial customers the benefit of putting the cash into their business operations.

CPS completed plans to enhance its key account program for the largest commercial customers. CPS will add five marketing representatives to provide a closer link to commercial customers for their current and future energy needs. The new plan includes 24-hour problem reporting and outage restoration priority.

Two of the four customer service centers were relocated to alleviate over-crowding and improve convenience for customers. In addition to allowing CPS customers to pay their bills and conduct business, one of the relocated centers serves as a one-stop location for customers to conduct business with CPS and with the city-owned water company.



Through the Pecan Valley Elementary Mentorship program, 18 CPS volunteers help students improve their grades and behavior.

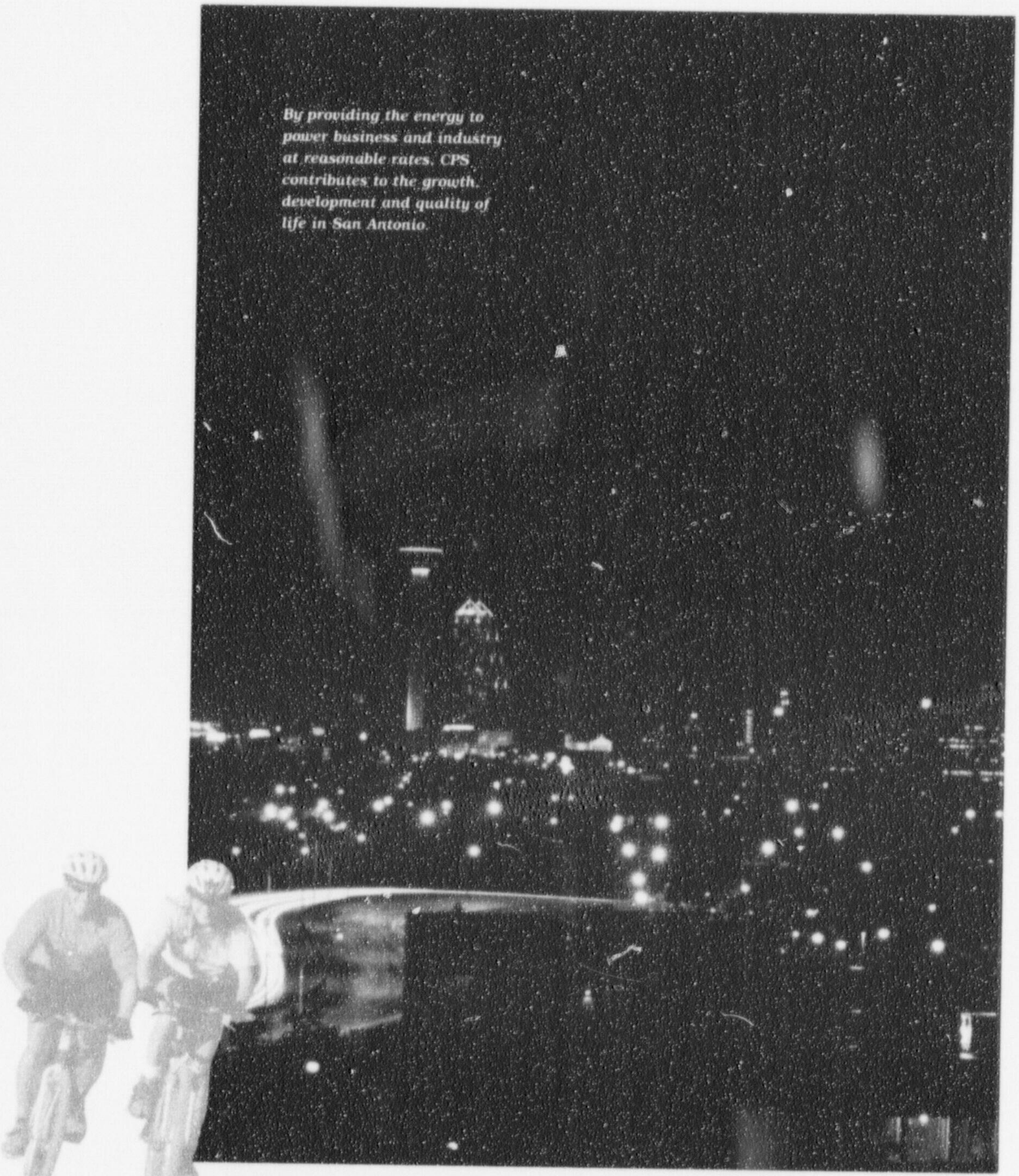
Although CPS has had a presence **On The Internet Since 1996** through the City of San Antonio, this fiscal year the utility set up its own web site at **www.citypublicservice.com**. Having its own location has allowed the utility to expand information available to internet users. CPS incorporated "The Electric Universe," 300 pages of information for educators about the electric utility industry, into the web page.

In addition to providing energy for San Antonio, the utility provides service through its economic impact on the community. Each year, CPS transfers 14 percent of its gross revenues to the City of San Antonio general fund which pays for numerous City services. The $138.5 million payment for the 1997-98 fiscal year represents the largest source of revenue for the City, approximately one-third of its general fund income. Since 1942, CPS has contributed approximately $2.2 billion to the municipal government.

For the second time, the CPS Small Business program received an outstanding rating, the highest attainable, from the U.S. Small Business Administration Region V for promoting the growth of the local economy. CPS pumped some $88 million in contracts into the San Antonio economy and increased minority firm participation in subcontracts by 200 percent. To date, no other agency or firm in the five-state region has received an outstanding appraisal. CPS previously achieved this top rating in 1994.

CPS employees served the community by volunteering and raising money for charitable donations. More than 85 percent of the active CPS work force and 139 retirees contributed to the CPS United Way campaign, raising a record $500,947. United Way funds more than 80 human service agencies which benefit one-fourth of the population in Bexar County. Energetic employees also charged life into the community through their work on volunteer projects. Under the Volunteers in Public Service program, 1,269 CPS employees contributed nearly 14,500 hours of volunteer service and raised more than $17,000 for non-profit organizations and community projects.

CPS PACING OURSELVES FOR STEADY GROWTH


By providing the energy to power business and industry at reasonable rates, CPS contributes to the growth, development and quality of life in San Antonio.

San Antonio is a dynamic city with a growing population. In 1997 that growt moved San Antonio into the position of eighth largest in the nation. The city's economy likewise continues to grow, achieving an annual job growth rate of 4.2 percent in 1997. San Antonio ranked seventh in the nation for new business formations in 1997, recording 9,363 new businesses.

City Public Service represents an important component of the positive business environment in San Antonio. By providing the energy to power business and industry at reasonable rates, the utility makes an important contribution to the growth and development of the San Antonio economy. That growth, in turn, produces requirements for more energy, assuring the utility will have a bright future.

Tourism, manufacturing, construction, insurance, retailing and medical care have continued to be important economic mainstays, along with one of the largest concentrations of military installations in the U.S. In recent years, San Antonio has **BROADENED ITS ECONOMIC BASE** to include numerous firms in the fields of electronics, data processing, biotechnology and telemarketing. That growing diversity puts the city in a good position to overcome the economic impact of closing Kelly Air Force Base in 2001. The Greater Kelly Development Corp. is charged with leasing facilities at the base for re-use as they are vacated by the military. The GKDC is working to convert the facilities into a modern aerospace industrial park and international logistics center.

Families enjoy the low cost and convenience of gas service.

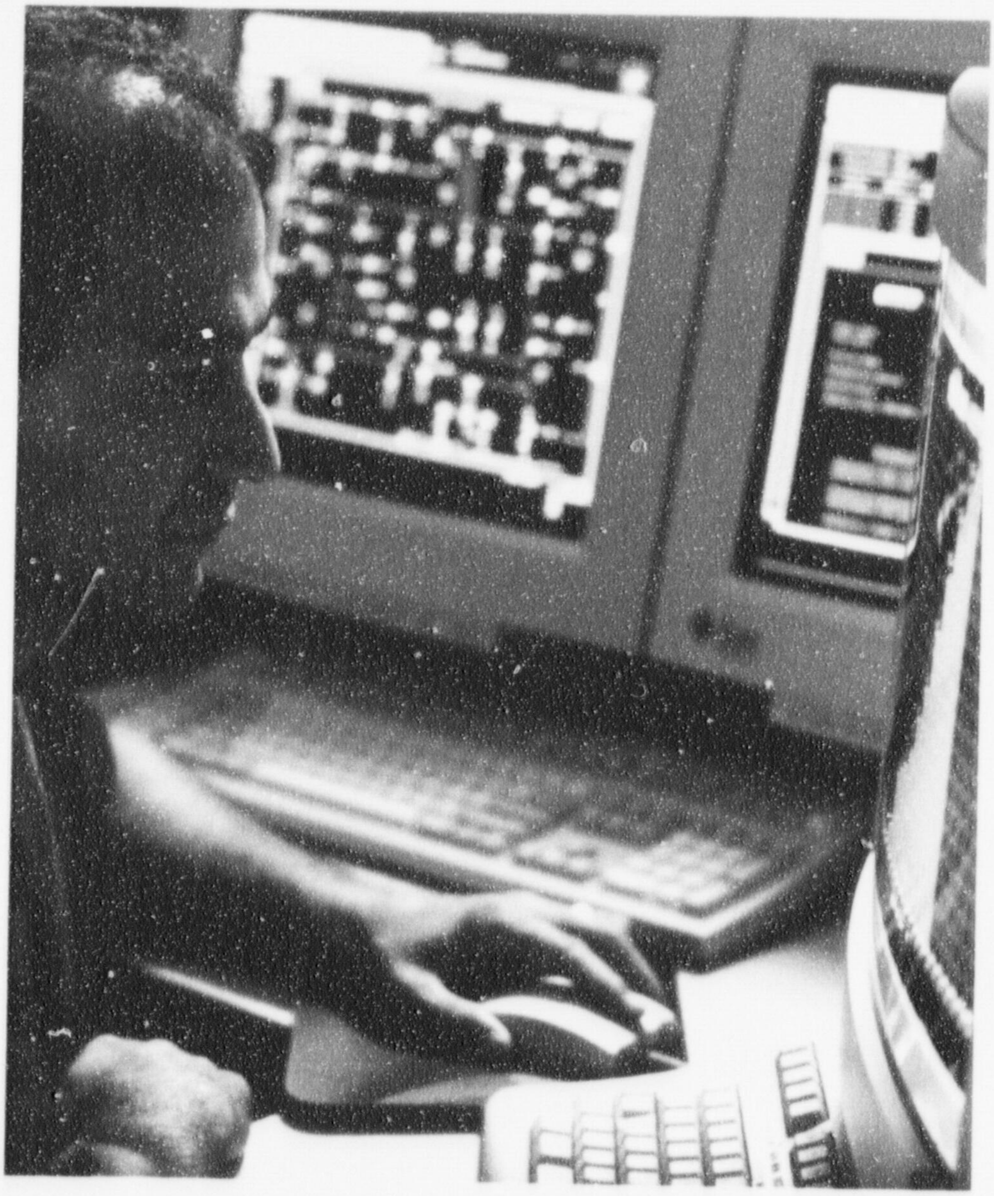
The Economic Development Foundation also continues to attract new businesses to San Antonio. During the fiscal year, 15 companies announced new locations or expansions in the Alamo City. The larger of the expansions included SBC Management Services which added 1,200 jobs and WorldCom which added 1,500. The economic development activity resulted in 3,215 new jobs for San Antonio.

New business translates into growth in utility customers. The number of CPS customers grew by 2 percent during the fiscal year, an increase of 996 natural gas customers and 10,661 electric customers. The customer growth rate has averaged 2.2 percent during the last five years, an average growth rate that is expected to continue for the next ten years.

As the number of utility customers grows, CPS continues to upgrade its systems to improve efficiency, reduce costs and provide excellent service to customers. **TECHNOLOGY** plays a major role in these improvements which not only are important for customers today but will allow the utility to continue preparing for the future.

The journey toward paperless communication of work orders and technical information took several more steps during the fiscal year. Work began on linking the utility's gas and electric system maps to databases of information about CPS facilities. When completed, the system will allow direct access to electronically stored facilities information so employees can plan projects, answer customer inquiries and update facility specifications. Users will be able to click on map components, such as transformers, switches and gas mains, to call up a screen display of pertinent information using a personal computer. These uses of technology represent an investment that will improve customer service and efficiency at the utility for the next several years.

Work on the utility's mobile data terminal system continued with installation of 200 laptop computers in utility trucks. Installation and testing of software is expected in the next fiscal year. When fully operational, the Integrated **MOBILE DATA COMMUNICATIONS SYSTEM**, which uses satellite global positioning,



Sophisticated computer systems are used in every aspect of the gas and electric utility.

will automate the dispatch of field personnel responding to customer needs. The state-of-the-art project consists of a series of management programs which consider scheduling, work load distribution and customer service needs. Field staff in vehicles will receive text and data service orders on vehicle-mounted screens using radio technology. The system will route available personnel based on job priority, job skill requirements, work loads and proximity to the job location.

Cost savings will be achieved through more efficient scheduling of personnel, and customer service will be improved through reduction of travel time to job locations. In some cases, the system will be used to dispatch personnel from home, further eliminating some administrative and travel costs. CPS anticipates saving $1.4 million per year through use of this technology.

Travel time also will be reduced through a communication link with the **SAN ANTONIO TRANSGUIDE SYSTEM** which provides information about traffic conditions on major expressways. The TransGuide infrastructure, which uses fiber optics, cameras, computers and overhead message signs, will provide information to the utility on the Internet. The information will enhance efficiency through reduced travel time, an increasing concern in a growing city.

Power plant improvements play a major role in the utility's ability to meet growing needs for electricity. During 1997-98, CPS made improvements that will enhance the utility's competitiveness in the future. Improvements in the control systems for Unit 3 of the gas-fired Braunig Plant will provide CPS with greater generating reliability, will allow tighter control of temperatures and pressures and better response to changes in generation needs and will lower maintenance costs. The first personal computer-based control system with a Windows NT operating platform in the U.S., the system marks the first step in a plan to retrofit control systems in other plants built in the 1960s and 1970s.

During the fiscal year, CPS further diversified its fuel supply in response to slow-downs in coal deliveries from Wyoming, the regular source of the utility's coal for generation. The utility **EXPANDED ITS OPTIONS FOR FUELS** by purchasing coal from South America and petroleum coke from the Texas coast. Undertaken on a test basis, these additional fuel options will enhance the utility's ability to generate electricity at reasonable rates to meet customers' needs for electricity in the future.

The ability to increase the natural gas distribution portion of the business was enhanced through an agreement with the utility's gas supplier for fixed prices on future deliveries. The fixed price will reflect the futures market price at the time CPS makes the agreement. The ability to establish firm prices will improve relationships with large volume gas customers who have expressed concern about price volatility. **FIRM PRICES** also will benefit electric customers by reducing the volatility of the fuel adjustment portion of the bill when gas is used extensively for generation.

In a first for the utility, CPS will purchase pipeline quality gas from a local landfill. About 5 percent of CPS resale gas requirements will be satisfied at below-market prices under the contract. ECOGAS will collect the landfill gas, remove contaminants, process the gas to remove carbon monoxide and deliver the gas to the CPS distribution system, with cost savings passed on to customers. The result will be somewhat lower gas prices as CPS looks at expanded competition in its gas business.

The landfill gas purchase also represents an enviromental benefit, since the gas would produce about 146 million kilowatt hours of electricity if it were used for generation. In buying the gas, CPS eliminates a major environmental problem from landfill gas and turns it into an environmental benefit equivalent to approximately 1 percent of the annual electrical generation requirement of the utility.

As growth continues in both the gas and electric businesses, CPS has the energy to serve a dynamic area and the ability to provide the commodities at competitive prices. Continuing improvements in the utility's infrastructure will assure that CPS can meet these needs not only in the near term but also in the future.

A CPS gas serviceman demonstrates how the utility will reduce response time to emergencies by receiving electronic work orders through the mobile data communications system, which will be installed in 200 vehicles.

CPS USING TEAMWORK TO SUCCEED

CPS construction crews and commercial planners work as a team to assist customers who are building new facilities.

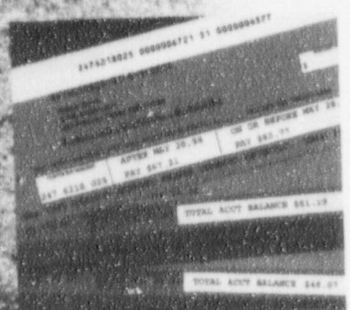
With a history of success and all the components in place to continue that tradition, CPS looks forward to a bright future. Customer satisfaction levels are high and CPS continues its record of low rates, well-functioning facilities and financial strength.

In focus groups and surveys conducted during the year, CPS customers said they value reliability and expect reasonable rates. When they have an opportunity to choose an electricity supplier, both factors will weigh in their decision.

Maryann Randle monitors legislative activity in Austin for CPS.

CPS has a history of reliable service and rates that compare favorably with those of other utilities. The utility intends to supplement those basic expectations of customers with **PRODUCTS AND SERVICES** that will help assure they make positive decisions to remain with CPS in the future.

CPS has improved the **BUDGET PAYMENT PLAN** as an initial step in developing new products and services. When the new program is offered to customers early in the next fiscal year, the utility expects residential, commercial and industrial customers to respond positively to the opportunity to pay the same amount each month while committing to CPS service for a specified period. Additional products and services, primarily for commercial and industrial customers, are being developed to respond to a variety of needs, from area lighting to energy management.



During the 1997-98 fiscal year, City Public Service customers paid among the lowest rates of major cities in Texas and the nation.

To help assure retention of residential and small business customers, CPS is considering alliances with a variety of potential vendors of products and services. Through **ALLIANCES WITH LOCAL BUSINESSES**, the utility seeks to maintain the dynamic small business environment so important to San Antonio while expanding the utility's offerings.

Because low rates will continue to be an important factor when customers choose electricity providers, CPS has undertaken several initiatives that will favorably affect costs.

A **DEBT MANAGEMENT PROGRAM** was initiated to reduce the debt component of the utility's costs, a move which will enhance the CPS competitive position. The initial two-year plan included options to increase the variable rate debt up to $600 million through tax exempt commercial paper, short-term variable rate demand bonds and/or interest rate swaps. The plan also calls for refunding high interest bonds and paying off debt when funds are available. During 1997-98, CPS increased the commercial paper program to $450 million, called $170 million of bonds and issued $661.2 million in revenue and refunding bonds. These refundings are projected to save $16.9 million in 1997 dollars over the next 16 years.

CPS also has initiated cost reduction measures in the organization's operations. The utility introduced a **NEW BUDGETING SYSTEM** which will provide management information to control costs more closely. Coupled with other initiatives, cost control measures proved instrumental in reducing the operating costs, excluding fuel, by 6.9 percent from the projected costs during 1997-98. The utility plans to carry these initiatives into future years to remain competitive.

As the Texas Legislature prepares for its next session in January 1999, CPS personnel are participating in hearings being held by the Senate Interim Committee on Electric Utility Restructuring. The committee will study a variety of issues, including rate reductions, stranded investments and renewable energy sources, to make recommendations to the Lieutenant Governor. CPS staff have testified in **UTILITY RESTRUCTURING PROCEEDINGS** and continue to monitor the legislative process through an office in the Texas capital. The CPS General

Manager now serves as President of the Texas Public Power Association and will represent the interests of municipal utilities in restructuring debates.

The utility also **CONTINUES TO CHALLENGE THE PUBLIC UTILITY COMMISSION RULES** that allocate the costs of open transmission access. The rules include a pricing structure which will cost CPS an estimated $15 million per year when put into full effect. The rules require CPS to pay a share of statewide transmission costs for all transmission-owning utilities, based on the CPS share of statewide electric load, and allow reimbursement based on a utility's actual costs. As the utility with the lowest transmission costs of any major electric company in the state and with relatively low use of others' transmission, CPS effectively will subsidize higher cost transmission-owning utilities. CPS has joined with two other utilities in legal action challenging the validity of the rules as inconsistent with PUC statutory authority. A state district court has upheld the pricing rule, but CPS and the other utility challengers were preparing an appeal at year end.

In looking to the future, CPS wants to ensure it has the generating capacity to serve its customers and to take advantage of **OPPORTUNITIES TO SELL WHOLESALE ELECTRICITY**. The utility projects that as early as 2001, at expected growth rates, CPS will need approximately 400 megawatts of additional generating capacity. While this capacity will be needed to provide low-cost power to customers in the current service area during peak times, the electricity also could be available for sale to make up for a growing shortfall in other parts of the state. CPS management is comparing the financial benefits of building a combined cycle plant, repowering an older unit already in the system or buying the required electricity. A decision by the middle of 1998 will allow time for construction, if that option is chosen.

AS CPS LOOKS AHEAD, the future holds uncertainties concerning legislative action on competition, legislation which could have a profound effect on the way utilities do business. Despite the uncertainties, CPS has confidence in its competitive position and will continue to participate in the legislative process to protect the interests of municipal utilities and their customers.

While looking ahead to future changes, CPS continues to concentrate on its core businesses and to expand its ability to offer new energy-related products and services. The utility's 3,475 employees are prepared to continue meeting the challenges of providing reliable service while controlling costs to assure rates remain low. CPS has an enviable financial position and serves a dynamic and growing community with facilities that are modern and well maintained. These factors provide the basis for optimism as CPS completes another successful year and looks ahead to a competitive environment.

CPS management staff is ready to tackle electric retail competition. From left to right are Bill Gunst, Senior Manager for Production; Ken Fiedler, Assistant General Manager for Customer and Distribution Services; Jamie Rochelle, Assistant General Manager for Corporate Services and Finance; Arthur von Rosenberg, General Manager; and Joe Treviño, Assistant General Manager for System Engineering and Engineering Services.

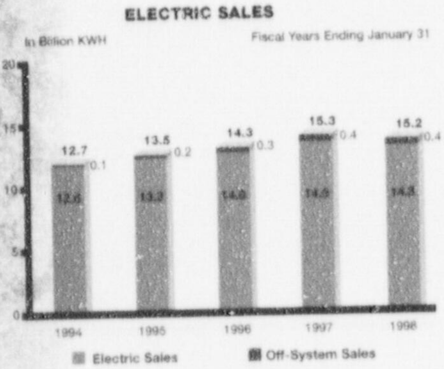
OPERATIONAL AND FINANCIAL REVIEW FOR 1997-98

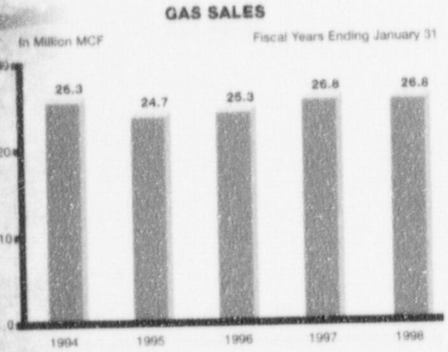
Fiscal year 1997-98 was an extraordinary one for CPS as it prepares for restructuring in the utility industry. CPS implemented new facets of its strategic plan designed to reduce the cost components of its pricing and to enhance its competitive position as a low-cost energy services provider. Current year accomplishments were highlighted by the implementation of a Debt and Asset Management Program in the spring designed to lower the debt component of energy costs, to maximize the effective use of cash and to enhance financial flexibility into the future. All of these factors are essential assets in a competitive environment. A company-wide team was developed to monitor regulatory and legislative activities affecting the electric industry. Also underway are reviews of the pricing structure and the implications of legislation at the state and national levels.

Financial results were strong for 1997-98 and were marked by record-breaking gross revenue, with CPS completing its sixth consecutive year without increasing rates. The communities served by CPS continue to benefit from rates that are among the lowest in the state and nation. Contributing to the gross revenue record were all-time high electric and non-operating revenue. Other significant highlights include reduced operating and maintenance expenses and substantially lower financing costs.

CPS assets of more than $5 billion reflect the utility's solid financial position. Net utility plant increased almost $35 million from expenditures for new facilities to a total of almost $4 billion at year-end. Restricted cash and investments reflected unspent bond proceeds from the May 1997 bond sale and the additional funds generated from this year's very favorable operations. In addition, CPS has accumulated more than $32 million in savings resulting from jointly dispatching CPS and Houston Lighting & Power Co. generating plants. CPS is evaluating the potential uses of the joint operating agreement savings to include the construction of a new combined cycle generating unit, purchased power arrangements to capitalize on wholesale energy demands and other economically beneficial projects.

Net long-term debt totaled $2.9 billion which included the new money and refunding bond issue in May and the $150 million increase in the commercial paper program. This year CPS defeased or retired $535 million of principal maturities through routine bond payments, the refunding issue and a call of bonds.





OPERATIONS

During 1997, CPS set an hourly peak demand record of 3,448 megawatts and a 24-hour usage record of 64,032 megawatt hours. The hourly peak demand record occurred on August 20, and marked the fourth time during the summer that the previous year's record of 3,356 had been broken. In addition, the new peak surpassed the 3,412 megawatt peak demand estimated for the summer period. The 24-hour usage record surpassed the 1996 record by 2.2 percent.

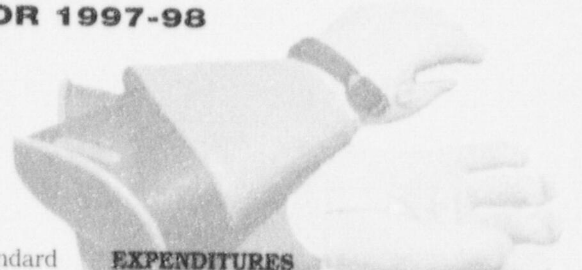
During the fiscal year, CPS supplied approximately 17 percent of its generation to HL&P, more than 3.1 billion kilowatt hours of electricity. The cumulative transfer of energy to HL&P through fiscal year 1997-98 was 5.4 billion kilowatt hours.

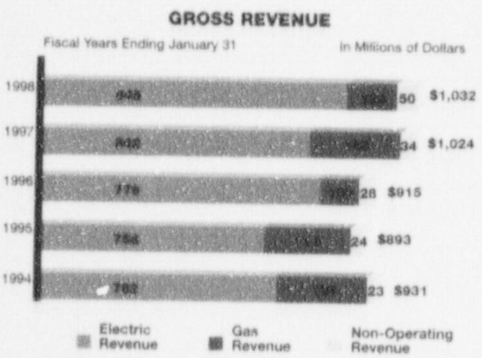
The CPS coal-fired units performed well in meeting the utility's generation requirements and achieving low production costs. Generation from coal accounted for 49.5 percent of the total during the fiscal year. Both CPS coal-fired units, J.T. Deely and J.K. Spruce, were the only two Texas plants ranking in the top twenty-five among the best performing 100 steam-electric power plants in the country, as reported by the Utility Data Institute for 1996 production costs.

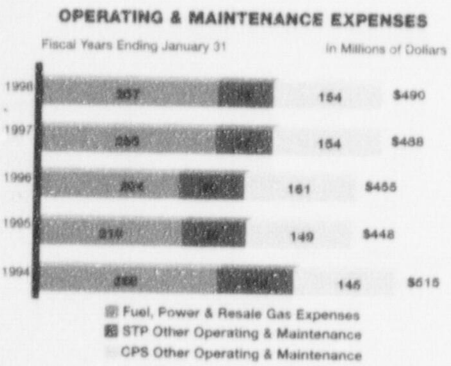
This fiscal year, CPS took steps to further its ability to provide low-cost power to its customers despite coal delivery delays and a volatile winter natural gas market. CPS received coal from an alternate supplier and rail carrier and also continued to diversify its fuel mix by purchasing petroleum coke.

CPS received 35.3 percent of its generation from the South Texas Project nuclear plant which is ranked among the top-producing nuclear plants in the country. STP also has been ranked among the lowest-cost electricity produced using nuclear energy, an important factor in maintaining low customer bills. Other STP achievements during 1997 include:

OPERATIONAL AND FINANCIAL REVIEW FOR 1997-98







• Unit 2 set a new 17.58-day standard for a refueling outage duration among the 109 operating U.S. commercial nuclear power plants, according to Nuclear Energy Institute records.

• Unit 1 accomplished the briefest refueling outage in its history and the second-best performance ever at STP.

REVENUE AND SALES

Gross revenue for fiscal year 1997-98 set a new record of $1.032 billion, slightly above the record set last year. Contributing to the increase in revenue was a re ord $844.8 million in electric system revenue, reflecting the recovery of fuel and purchased power costs which were about 8.3 percent greater than last fiscal year. Electric sales reached 15.2 billion kilowatt hours and were essentially the same as last year due in part to a milder summer than in the previous year. CPS served an average of 10,660 more electric customers than the previous year. In addition, off-system sales to other utilities and power marketers have been modest and increasing at a steady rate.

Gas system revenue of $137.6 million decreased 7 percent from last fiscal year, primarily resulting from the recovery of lower gas costs, as the unit price of gas was 14 percent lower. The unit price of gas this year was more typical than the level experienced in 1996-97, when increased demand occurred due to the cold winter weather throughout the country. Gas sales amounted to 26.8 million MCFs and were essentially the same as the prior year. An additional 996 gas customers were served by the utility during fiscal year 1997-98.

CPS reported a record $49.8 million in non-operating revenue which includes interest on investments and miscellaneous income. The increase reflects the greater earnings on investment of the 1997 bond proceeds and higher operating and other fund balances.

EXPENDITURES

Fiscal year operating and maintenance expenses amounted to $490 million and in total were essentially the same as last year. Generation fuel and gas for resale cost $256.8 million, $1.8 million more than the prior year, primarily as a result of the greater use of higher cost gas in the generation mix this fiscal year. The overall average cost for generation fuel and purchased power reflected a 7.8 percent increase for the year. Non-fuel operating and maintenance expenses were essentially the same as the 1996-97 fiscal year, reflecting management's continued cost control initiatives.

South Texas Project operating and maintenance expenses, while 5.4 percent below the 1997-98 budgeted level, were essentially the same as the prior year. Two refuelings were performed during the current fiscal year as compared to a single refueling in fiscal year1996-97.

In fiscal year 1997-98, CPS was faced with complying with the Transmission Pricing and Access Rule, which was designed by the Public Utility Commission of Texas to comply with legislative mandates to charge electric customers for wholesale open transmission access. The cost to CPS for this fiscal year totaled $1.8 million.

While maintaining low customer bills, CPS was able to increase its contribution for payments and services to the City of San Antonio in fiscal year 1997-98 to $138.5 million, a record transfer of earnings. Since its inception in 1942, CPS has contributed more than $2.2 billion to the City of San Antonio's General Fund.

The utility's debt service and reserve requirements for 1997-98 totaled $203.3 million, a decrease of almost 31 percent from the prior year. This was a direct result of the Debt Management Strategic Initiative implemented in the spring. This strategy was designed to reduce the debt component of the utility's price, maintain favorable credit ratings, optimize the use of cash resources and enhance the CPS competitive position.

OPERATIONAL AND FINANCIAL REVIEW FOR 1997-98

These goals were achieved partly by using less revenue for principal requirements. Lower principal requi .nents this fiscal year resulted from the ს170 million call of bonds with commercial paper proceeds, as the call included $32 million of bonds that were due February 1, 1998. This financing transaction also resulted in interest savings from replacing higher interest debt with lower interest debt. The temporary suspension of commercial paper principal redemption also contributed to achieving the objectives by making funds available for other strategic competitive initiatives.

CAPITAL AND NET REMOVAL COSTS

Expenditures for the replacement, improvements, expansion of the gas and electric systems, and net removal costs, were $204.2 million, $32.1 million greater than last year. The increase resulted from construction activities in all major categories, reflecting the utility's commitment to provide safe and reliable energy to its customers. Major projects included replacement of direct-buried electric cable with cable in conduit, steel gas services replaced with polyethylene pipe in residential areas and considerable progress on the second outer gas loop that will encircle San Antonio by the year 2000. The utility also has made technological investments, reflecting the commitment to providing excellent service to customers now and in the future.

At the expected growth rates, the utility projects the need for approximately 400 megawatts of additional generating capacity by 2001. Evaluations are underway comparing the cash requirements and benefits associated with building a plant, repowering an older unit or buying the required electricity.

During 1997-98, CPS sold $350 million in revenue bonds. Proceeds from this and the 1995 bond issue of $125 million were used to fund 74.8 percent of this year's construction expenditures. The $242.6 million balance in bond proceeds is expected to fund capital additions through next fiscal year

Reve ıe from current operations provided 19.4 percent of this year's construction expenditures. Customer contributions funded 3.6 percent, while tax-exempt commercial paper financed 2.2 percent.

FINANCING

CPS had made significant efforts since 1983 in managing and controlling the cost of debt as part of the price of gas and electricity. However, further efforts were made during 1997-98 to reduce the overall debt component to ensure the price for energy is competitive in the future.

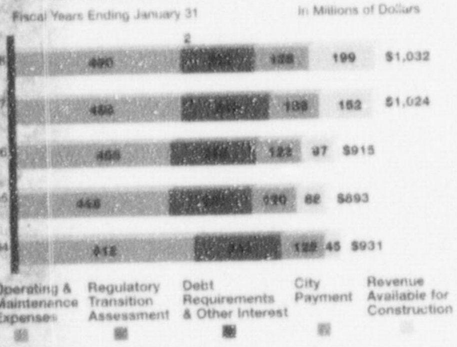
In May 1997, CPS was involved in the third largest bond issue in the utility's history, taking advantage of the low interest rates in the bond market. CPS issued $661.2 million of New Series 1997 bonds, consisting of a combination of $311.2 million in refunding bonds and $350 million in revenue bonds. This refunding is anticipated to save ratepayers at least $9.1 million in 1997 dollars over the life of the refunding issue.

In June 1997, the tax-exempt Commercial Paper Program was expanded to a limit of $450 million from a former limit of $300 million. In July, CPS issued $170 million in low interest TECP notes, $150 million from the currently expanded program and $20 million still available from the former limit. The decision to increase CPS variable rate debt was partially due to the level of cash and reserves in relation to the total debt outstanding. In August, the utility used these proceeds to call $170 million of higher interest New Series Bonds for interest savings. The expected net present value savings from this transaction is approximately $7.8 million.

These financing transactions resulted in $2.58 billion of fixed rate bonds on January 31, 1998, or 85.2 percent of total debt. CPS variable rate commercial paper

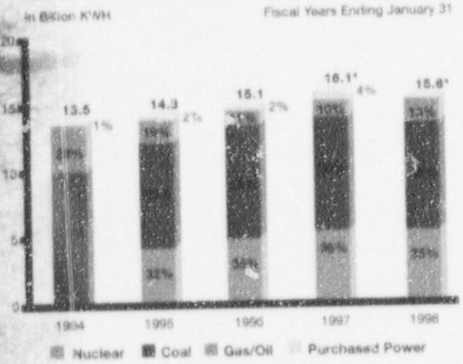
GROSS REVENUE & APPLICATION OF REVENUE

Fiscal Years Ending January 31 — In Millions of Dollars



ELECTRIC GENERATION & PURCHASED POWER

In Billion KWH — Fiscal Years Ending January 31



* Excludes joint system operations generation.

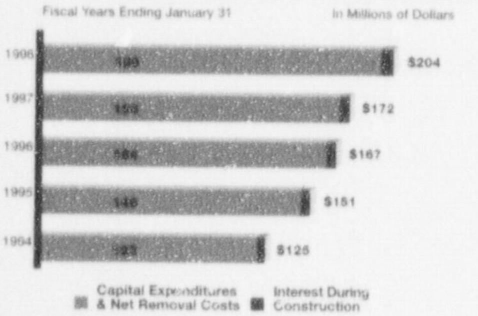
OPERATIONAL AND FINANCIAL REVIEW FOR 1997-98

of $450 million at year-end represents the remaining 14.8 percent of total debt. The weighted average interest rate on outstanding bonds and commercial paper on January 31, 1998, was 5.53 percent and 3.69 percent, respectively. The bond principal and interest coverage at the end of this fiscal year was 2.79, a record level for at least the last ten years.

CPS customers continue to reap the benefits from lower financing costs through the utility's ability to maintain the highest rated debt for municipal utiuties in the country. Fitch Investors Service, L.P., Moody's Investors Service, Inc. and Standard & Poor's Rating Group assigned ratings of AA+, Aa1, and AA, respectively, to the New Series 1997 Bonds. They also gave the highest ratings issued to CPS variable rate debt under the commercial paper program.

In their review of utilities, both Fitch and Standard and Poor's ranked CPS among the best in the industry. The Fitch Competitive Indicator ranked CPS the second best among the 89 municipal and investor-owned utilities they considered in their competitive indicator rating. In the Standard & Poor's Business Profile rankings, CPS was included in the second highest category among the 58 public retail electric utilities considered in their credit rankings.

CAPITAL EXPENDITURES & NET REMOVAL COSTS

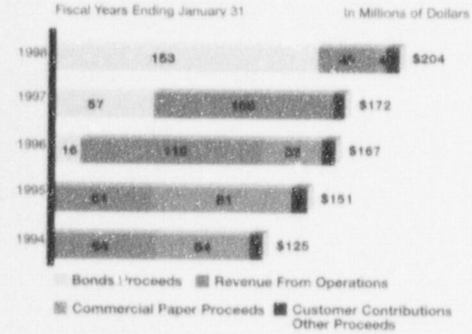


FUTURE PLANS

During 1997-98, a corporate team was created to accelerate the review of all systems and to develop appropriate strategies to assure year 2000 compliance. The plan includes milestones that will ensure that all core systems will be fully operational and the delivery of services to customers uninterrupted well before the year 2000.

In preparation to successfully operate in a competitive environment, CPS has developed a marketing plan that focuses on retaining customers. Programs focus on meeting the needs of the customers, including new products and services, offering commercial customers the option to sign long-term service agreements, deferring utility deposits for some customers, improving the facilities in which customers transact business and offering electronic payment plans.

FUNDING OF CAPITAL PROJECTS & NET REMOVAL COSTS



Looking to the future, CPS plans to continue to focus on diversifying revenue sources by offering new energy-related products and services, continuing to provide low cost generation and exemplary reliability to the communities it serves and working on customer retention by improving and developing strong customer loyalty. In addition, CPS expects to see continued growth in its customer base for the electric and gas systems. The energy sales forecast also indicates modest increases in both electric and gas sales.

With respect to state and national legislative action regarding competition, CPS will continue to actively participate in the legislative process to voice the interests of municipal utilities and be 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 the debt management strategies will continue in the year ahead.

BALANCE SHEETS

	January 31, 1998	January 31, 1997
	(In thousands)	
Assets		
UTILITY PLANT, at cost *(Notes 1, 9, and 11)*:		
Plant in service —		
Electric	$ 4,652,055	$ 4,544,452
Gas	355,245	322,611
General	157,680	133,353
Total plant in service	5,164,980	5,000,416
Less-accumulated depreciation	1,536,662	1,402,951
Plant in service, net	3,628,318	3,597,465
Construction work in progress	196,802	182,958
Nuclear fuel, less accumulated amortization of $167,513 in 1998 and $143,760 in 1997	44,251	54,256
Held for future use	31,384	31,384
Utility plant, net	3,900,755	3,866,063
RESTRICTED CASH AND INVESTMENTS *(Notes 1, 2, and 3)*:		
Bond construction fund	246,018	51,735
New series bonds debt service and reserve requirements	207,852	215,462
Repair and replacement account	291,748	134,572
Electric overhead conversion fund	33,623	27,040
Joint operations agreement savings fund *(Note 9)*	32,521	15,626
Cash restricted for customer service deposits	25,759	26,122
Other	19,037	18,610
Total restricted cash and investments	856,558	489,167
CURRENT ASSETS:		
Cash and temporary investments *(Notes 1 and 2)*	56,450	41,064
Customer accounts receivable, less allowance for doubtful accounts of $2,031 in 1998 and $2,524 in 1997	64,146	69,661
Other receivables	23,607	13,804
Inventories and supplies, at average cost —		
Materials and supplies	60,137	58,429
Fuel stock	18,447	29,877
Prepayments and other	8,477	8,034
Total current assets	231,264	220,869
OTHER ASSETS AND DEFERRED COSTS:		
Deferred compensation plan *(Notes 1 and 6)*	32,030	27,875
Other *(Note 1)*	11,983	10,810
Total other assets and deferred costs	44,013	38,685
TOTAL ASSETS	$ 5,032,590	$ 4,614,784

The accompanying notes are an integral part of these financial statements.

Equity and Liabilities

	January 31, 1998	1997
	(In thousands)	
LONG-TERM DEBT:		
New series bonds *(Notes 3 and 4)*	$ 2,350,005	$ 2,192,205
New series capital appreciation bonds *(Note 4)*	170,993	170,993
Total new series bonds	2,520,998	2,363,198
Unamortized discount on new series bonds	(53,506)	(67,168)
Accreted discount on capital appreciation bonds	113,916	94,708
Unamortized costs of bond reacquisition	(170,541)	(166,386)
New series requirements, net	2,410,867	2,224,352
Commercial paper *(Note 5)*	450,000	250,800
Long-term debt, net	2,860,867	2,475,152
EQUITY:		
Reserved retained earnings *(Note 3)* —		
New series bonds debt service and reserve requirements	155,394	163,004
Repair and replacement account	291,748	134,572
Electric overhead conversion fund *(Note 1)*	33,623	27,040
Total reserved retained earnings	480,765	324,616
Unreserved retained earnings invested in or designated for plant and working capital	1,417,602	1,509,367
Total equity	1,898,367	1,833,983
CURRENT LIABILITIES:		
Current maturities of revenue bonds *(Note 4)*	61,640	93,145
Current portion of commercial paper redemption *(Note 5)*	0	27,000
Accounts payable and accrued liabilities	87,269	83,068
Total current liabilities	148,909	203,213
OTHER LIABILITIES AND DEFERRED CREDITS:		
Restricted —		
Joint operations agreement savings deferred credit *(Notes 1 and 9)*	32,521	15,626
Customer service deposits	25,759	26,122
Other *(Note 1)*	15,450	15,779
Customer advances for construction *(Note 1)*	13,555	12,149
Deferred compensation plan liability *(Notes 1 and 6)*	32,030	27,875
Other liabilities and credits *(Note 1)*	5,132	4,885
Total other liabilities and deferred credits	124,447	102,436
COMMITMENTS AND CONTINGENCIES *(Notes 3, 6, 7, 9, and 10)*	—	—
TOTAL EQUITY AND LIABILITIES	$ 5,032,590	$ 4,614,784

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

	Years Ended January 31, 1998	1997
	(In thousands)	
OPERATING REVENUES *(Note 1)*:		
Electric	$ 844,848	$ 841,699
Gas	137,593	147,980
Total operating revenue	982,441	989,679
OPERATING EXPENSES *(Note 1)*:		
Fuel, purchased power and resale gas	256,836	255,055
Other operating and general	157,291	161,874
Maintenance	75,835	71,423
Regulatory transition assessment *(Note 10)*	1,851	—
Depreciation	153,407	146,559
Tax equivalent to City of San Antonio *(Note 8)*	—	15,154
Total expenses	645,220	650,065
OPERATING INCOME	337,221	339,614
NONOPERATING INCOME (EXPENSE) *(Note 1)*:		
Interest and other income	40,761	34,636
Interest expense	(146,032)	(141,869)
Accreted discount on capital appreciation bonds	(19,208)	(17,913)
Amortization of debt reacquisition, issuance, discount and other costs	(23,558)	(23,035)
Allowance for interest during construction	4,743	3,654
INCOME BEFORE OPERATING TRANSFERS	202,927	195,087
Payments to the City's General Fund *(Note 8)*	(138,543)	(122,434)
NET INCOME	64,384	72,653
ACCUMULATED RETAINED EARNINGS AT BEGINNING OF YEAR	1,833,983	1,761,330
ACCUMULATED RETAINED EARNINGS AT END OF YEAR	$ 1,898,367	$ 1,833,983

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

	Year Ended January 31, 1998	1997
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating income	$ 337,221	$ 339,614
Noncash items included —		
Depreciation expense	153,407	146,559
Changes in current assets and liablities:		
(Increase) decrease in customer accounts receivable	5,515	(15,236)
(Increase) decrease in other receivables	(12,494)	(251)
(Increase) decrease in inventories and supplies	9,722	2,066
(Increase) decrease in prepayments and other	(443)	(2,550)
Increase (decrease) in accounts payable and accrued liabilities	4,201	11,355
Changes in other assets, deferred costs, other liabilities, and deferred credits:		
(Increase) decrease in STP nuclear fuel and other assets	10,069	16,419
Increase (decrease) in customer service deposits payable	(363)	346
Increase (decrease) in other liabilities and deferred credits	(82)	(670)
Net cash provided by operating activities	506,753	497,652
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Cash paid for additions to utility plant and removal costs	(199,471)	(167,813)
Contributions in aid and customer advances for construction	7,392	6,928
Proceeds from issuance of revenue bonds	345,964	0
Proceeds from issuance of commercial paper	174,500	0
Principal payments on revenue bonds	(232,325)	(88,700)
Commercial paper redeemed	(2,300)	(17,300)
Interest paid	(146,032)	(141,869)
Debt issue costs paid	(2,508)	0
Joint operations agreement proceeds	16,895	15,626
Old series bond reserve defeasance	0	(16,552)
New series bond reserve asset transfer	0	16,552
Net cash used for capital and related financing activities	(37,885)	(393,128)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Payments to the City's General Fund	(138,543)	(122,434)
Net cash used for non-capital financing activities	(138,543)	(122,434)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(1,277,250)	(954,965)
Proceeds from sales and maturities of investments	977,174	857,358
Interest and other income	49,761	34,636
Net cash used for investing activities	(250,315)	(62,971)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	80,010	(80,881)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	26,679	107,560
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 106,689	$ 26,679
Reconciliation of Cash and Investments:		
Restricted Cash and Investments:		
Cash and cash equivalents	$ 50,239	$ 17,434
Investments	806,319	471,733
Total	856,558	489,167
Current Assets:		
Cash and cash equivalents	56,450	9,245
Investments	0	31,819
Total	56,450	41,064
Total Restricted and Current Assets:		
Cash and cash equivalents	106,689	26,679
Investments	806,319	503,552
Total	$ 913,008	$ 530,231

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS JANUARY 31, 1998 AND 1997

1. Significant Accounting Policies

ORGANIZATION — City Public Service (CPS), a municipal utility owned by the City of San Antonio (the City), provides electricity and natural gas to San Antonio and surrounding areas. As a municipal utility, CPS is exempt from payment of income taxes, state franchise and sales taxes, and real and personal property taxes. CPS provides certain payments and benefits to the City as described more fully in Note 8.

BASIS OF ACCOUNTING — The financial statements of CPS are presented in accordance with generally accepted accounting principles for proprietary funds of governmental entities. Accounting records generally follow the Uniform System of Accounts for Electric and Gas Utilities issued by the National Association of Regulatory Utility Commissioners.

CPS has elected not to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, which is an alternative of the Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting. This election avoids conflicts created when the FASB issues standards that conflict with GASB pronouncements.

FISCAL YEAR — The fiscal year ended January 31, 1998, is referred to herein as 1998; the fiscal years ended January 31, 1997, January 31, 1996, and January 31, 1995 as 1997, 1996, and 1995 respectively.

REVENUE AND EXPENSES — Revenue is recognized as billed on a cycle basis. Rate schedules include fuel and gas cost adjustment clauses that permit recovery of fuel and gas costs in the month incurred. CPS reports fuel and resale gas costs on the same basis as it recognizes revenue.

CPS amortizes its share of nuclear fuel for the South Texas Project (STP) to fuel expense on a unit-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 is charged a fee for disposal of spent nuclear fuel, which is included in fuel expense, in the amount of $0.00093 per generated kilowatt hour (KWH) for its share of electricity produced by STP. For further discussion regarding the STP, see Note 9.

UTILITY PLANT — Utility plant is stated at the cost of construction, including costs of contracted services, direct material and labor, indirect costs, including general engineering, labor and material overhead, and an allowance for interest used during construction (AIUDC). CPS computes AIUDC using rates which approximate the cost of borrowed funds. AIUDC is applied to projects estimated to cost in excess of $250,000.

Proceeds from customers to partially fund construction expenditures are credited against the costs for the projects. Retirements of utility plant, together with removal cost less salvage, are charged to accumulated depreciation. The maintenance of property, as well as replacements and renewals of items determined to be less than a unit of property, are charged to maintenance expense. General utility plant assets consist of land, buildings, and equipment for general and administrative purposes that are used commonly in electric and gas operations.

CPS computes depreciation using the straight-line method over the estimated service lives of the various classes of depreciable property. Depreciation as a percentage of average depreciable plant was 2.99 percent in 1998 and 2.95 percent in 1997.

RESTRICTED CASH AND INVESTMENTS — These funds are generally restricted for uses other than current operations. They may be designated or segregated to acquire or construct non-current assets. Funds consist primarily of unspent bond issue proceeds, debt service and reserves required for the New Series Bonds and commercial paper, and funds for future construction or contingencies.

In 1995, the CPS Board authorized that a reserve be established for converting overhead electric facilities to underground. This fund includes one percent of the prior fiscal years electric revenue from cities and unincorporated areas served by CPS. When the fund was initially established, the appropriated amount included revenue associated with fiscal years 1993-94 and 1992-93. The appropriated funds and reserved retained earnings at January 31, 1998 represent the unused balance from 1994 through January 31, 1998.

As of February 1, 1997, the Old Series Bonds were fully defeased. The remaining balance in the Old Series Bond Reserve was transferred to the New Series Bond Reserve at the end of January 1997 and used to fund New Series debt service requirements in February 1998. For further discussion regarding the Old Series Bonds, New Series Bonds, and their corresponding reserves, see Note 3.

Restricted Cash and Investments also includes the Joint Operations Agreement Savings Fund, which was established in June, 1996. The Joint Operations Agreement resulted from the litigation settlement with Houston Lighting and Power over its management of the South Texas Nuclear Project during the construction and operating periods. CPS receives in cash monthly ninety percent of the savings realized from the jointly operated systems. The CPS Board authorized that the funds be segregated until a formal plan for their use is adopted. In December 1997, the CPS Board preliminarily committed a portion of the Joint Operations Savings to partially fund the construction of a new generating facility; a final decision will be made in fiscal year 1999 based upon the evaluations of the proposals.

CPS Customer assistance program funds, and insurance reserves are also included in this category.

Investments are stated at amortized cost which approximates market value. The specific identification method is used to determine cost in computing gain or loss on sales of securities. Amortization of premium and accretion of discount are recorded over the terms of the investments.

OTHER ASSETS AND DEFERRED COSTS — Deferred employee compensation, which is held by two authorized 457 Plan fund managers, is reported at market value as a non-current asset. In February 1998, the Plan was amended to provide that two trusts hold all assets for the exclusive benefit of participants and their beneficiaries. Other amounts consist of unamortized debt issuance expenses, which are amortized over the period of the outstanding bonds.

Non-current deferred costs also include a special assessment fee by the Federal Energy Regulatory Commission for decommissioning of U.S. nuclear fuel enrichment facilities. CPS recorded this in fiscal 1994 to be amortized over a 15-year period to nuclear fuel expense.

OTHER LIABILITIES AND DEFERRED CREDITS — These amounts consist primarily of liabilities relating to deferred employee compensation, nuclear fuel assessment fee which is paid in annual installments as enrichment decontamination and decommissioning, customer assistance program contributions, customer advances for construction, and the Joint Operations Agreement Savings deferred credit. Operating reserves for property insurance and injuries and damages are also included in this category.

STATEMENT OF CASH FLOWS — For purposes of reporting cash flows, CPS considers all highly liquid debt instruments purchased with a maturity of approximately three months or less to be cash equivalents. No material noncash investing transactions occurred during 1998 and 1997. However, there was a material noncash financing transaction involving a refunding bond issue that occurred during 1998. For further discussion, see note 4.

RECLASSIFICATIONS — Certain amounts in all the 1997 financial statements have been reclassified in order to conform with the 1998 presentation. A new combined Statement of Revenues, Expenses, and Changes in Retained Earnings is presented for 1998. The 1997 figures presented in this statement were reported last year on the Statement of Revenues and Application of Revenues and Statements of Changes in Equity.

2. Cash and Temporary Investments

CPS cash deposits at January 31, 1998, and 1997, were entirely insured or collateralized by banks for the account of CPS. For deposits that were collateralized, the securities were U.S. Government obligations held in book entry form by the Federal Reserve Bank in CPS' name. CPS' cash book values were $4.7 million at January 31, 1998, and CPS' bank balances were $16.0 million also at year end.

At January 31, 1998, and 1997, CPS' investments, both restricted and unrestricted, were all in U.S. Government or government agency obligations and were held in book entry form by the Federal Reserve Bank in CPS' name. CPS' investments are generally limited to U.S. Government or Government Agency or U.S. Government guaranteed obligations by CPS Board Resolution and Policy, Bond Ordinances, and State Law. Investments carried at amortized cost plus accrued interest were $908.8 million with a market value of $920.0 million at January 31, 1998, and were $524.6 million with a market value of $530.1 million at January 31, 1997.

3. Revenue Bond Ordinance Requirements

As of February 1, 1997, the Old Series Bonds were totally defeased; the Trust Indenture covering the Old Series Bonds became inoperative; and the provisions set forth by the Bond Ordinances for the New Series Bonds became effective. The New Series Bond Ordinances contain, among others, the following provisions:

(1) Gross Revenue is applied as follows: (a) for maintenance and operating expenses of the systems, (b) for payments of the New Series Bonds, including the establishment and maintenance of the reserve therefor, (c) for the payment of any obligations inferior in lien to the New Series Bonds which may be issued, (d) for an amount equal to 6 percent of the gross revenues of the systems to be deposited in the Repair and Replacement Account, (e) for cash payments and benefits to the City not to exceed 14 percent of the gross revenues of the systems, and (f) any remaining net revenues in the General Account to the Repair and Replacement Account.

(2) The following accounts are established: a) General Account, (b) Repair and Replacement Account, (c) Bond Construction Account (containing the proceeds of revenue bonds), (d) Retirement Account - interest and sinking fund portion (containing the monthly principal and interest payments on the New Series Bonds), and (e) a Bond Reserve Fund portion (equal to not less than the average annual principal and interest requirements of all outstanding New Series Bonds). As of January 31, 1998, bond reserve requirements for the New Series Bonds have been met.

4. Revenue Bonds

A summary of revenue bonds is as follows:

	Maturities	Weighted-Average Interest Rate on Outstanding Bonds at January 31,1998	January 31 1998	January 31 1997
			(In thousands)	
New Series Serial Bonds, 1977- 1997	1999 - 2020	5.355%	$2,411,645	$2,285,350
New Series Capital Appreciation Bonds, 1989 and 1991	2002 - 2012	7.221%	170,993	170,993
Total new series bonds outstanding		5.528%	2,582,638	2,456,343
Less: Current maturities of bonds			61,640	93,145
Total new series bonds outstanding, net of current maturities			$2,520,998	$2,363,198

Principal and interest amounts due (in thousands) for each of the next five years and thereafter to maturity are:

Year	Principal	Interest	Total
1999	$ 61,640	$ 128,462	$ 190,102
2000	95,290	124,822	220,112
2001	92,395	119,942	212,337
2002	79,442	140,582	220,024
2003	77,309	141,532	218,841
Thereafter to maturity	2,176,562	1,260,920	3,437,482
Total	$ 2,582,638	$ 1,916,260	$ 4,498,898

In May 1997, CPS issued $661.2 million of New Series 1997 bonds at an average interest rate of 5.65 percent. The issue consisted of $350 million in revenue bonds and $311.2 million in refunding bonds. The new money bonds are expected to fund most construction requirements through the next fiscal year and partly into the fiscal year ending January 31, 2000.

The refunding bonds were issued to refund $302.6 million in certain outstanding New Series Bonds, and were $8.6 million more than the amount of bonds refunded. The refunding transaction resulted in cash flow savings of $15.7 million, which equates to a present value savings of $9.1 million, or 3.0 percent of the par amount of refunded bonds.

In August 1997, CPS issued a call for $170 million in New Series Bonds, including $32 million in maturities due at year-end. For further discussion, see Note 5.

In prior years, CPS refunded certain previously issued and outstanding New Series Bonds through the issuance of New Series Revenue Refunding Bonds. The refunded bonds and related trust accounts are not included in CPS' financial statements. At January 31, 1998, portions of the bonds (in thousands) which have been defeased were still outstanding as follows:

Fiscal year 1995 refunding	$ 99,555
Fiscal year 1998 refunding	297,695

5. Commercial Paper

In October 1988, the City Council of San Antonio, Texas (City Council) adopted an ordinance authorizing the issuance of up to $300 million in Tax-Exempt Commercial Paper (TECP). This ordinance as amended provides for funding to assist in the financing of eligible projects, including fuel acquisition and capital improvements to the utility systems (the Systems), and to refinance or refund any outstanding obligations which are secured by and payable from a lien on and/or a pledge of net revenues of the Systems. The program's scheduled maximum maturities will not extend beyond November 1, 2028.

In June 1997, the City Council approved an amendment to the ordinance which allowed for the expansion of the TECP Program to a limit of $450 million. Subsequently, CPS issued $20 million still available from the $300 million former limit, and $150 million in additional TECP notes. Proceeds were used to call $170 million of New Series Bonds in August 1997. The bond call transaction resulted in expected cash flow savings of $8.8 million during the term of the called bonds, which equates to an expected present value savings of $7.8 million.

CPS sold an additional $4.5 million of TECP during October 1997 which was used to fund construction costs for that month, bringing the total amount of TECP outstanding to the program's new limit of $450 million.

CPS had been following a self-imposed schedule to pay off the balance of the principal used for the redemption of $211 million of long-term debt in August 1994. Under this payback, $2.3 million was redeemed in 1998; $17.3 million was redeemed during 1997; $16.7 million was redeemed during 1996; $16.9 million was redeemed during 1995; and $5.6 million was redeemed during 1994. In March 1997, the CPS Board of Trustees approved a resolution to temporarily suspend the commercial paper principal redemption. This was part of CPS' Debt Management plan to maintain a higher outstanding amount of variable rate debt.

As of January 31, 1998, $450 million in principal amount was outstanding, with a weighted-average interest rate of approximately 3.69 percent and an average life of approximately 96 days.

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 agreement, CPS may borrow up to an aggregate amount not to exceed $450 million for the purpose of paying amounts due under the TECP. The credit agreement has a term of two years, currently extended until November 1, 1999, and may be renewed for additional periods.

To date, there have been no borrowings under the 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 the New Series Bonds and any New Series Bonds to be issued in the future.

6. Benefit Plans

The City Public Service of San Antonio Employees' 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. Normal retirement is age 65; however, early retirement is available with 25 years of benefit service. Retirement benefits are based on length of service and compensation, and benefits are reduced for retirement before age 55. The Plan is sponsored by and may be amended by CPS, acting by and through the General Manager of CPS. The Plan assets, having a market value of $573.2 million at December 31, 1997, are held in a separate trust that is periodically audited and which statements include historical trend information. For further information, contact the Employee Benefits Division at CPS.

The current policy of CPS is to establish funding levels, considering annual actuarial evaluations and recommendations of the Administrative/Investment Committee, using both employee and employer contributions. Generally, participating employees contribute 5 percent of their total compensation and are normally fully vested in CPS' contribution after completing 15 years of credited service. Such contributions commence with the effective date of participation, and continue until attaining normal or early retirement age or termination of employment. The balance of contributions are the responsibility of CPS, acting by and through the General Manager of CPS, considering actuarial information, budgetary compliance, and the need to amend the Plan to comply with legal requirements or to ensure that the Plan is appropriate and within the industry and community.

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:

	1998	1997
	(In thousands)	
Employee contributions	$ 6,005	$ 6,061
CPS contributions	12,426	14,267
Total contributions	$ 18,431	$ 20,328
Covered payroll	$ 123,826	$ 125,173
Total payroll	$ 129,313	$ 128,620

The actuarially determined contribution requirement for 1998 was computed using an assumed rate of return of 8.5 percent. For 1998 the past-service costs were amortized over a targeted 15 years, as compared to a 20-year amortization for 1997, 1996 and 1995, and a 30 year amortization for prior years. There were no changes in actuarial assumptions or cost methods from 1997 to 1998.

Effective December 1, 1996, the Plan was amended whereby the inservice death benefit for active employees with 25 or more years of benefit service has been changed to equal the amount payable as if the participant had retired under the joint and 50% survivor annuity form under certain stated spousal criteria, as defined under the Plan. The effect of this change was an increase in the January 1, 1997 Pension Benefit Obligation of $1.6 million and an increase in the actuarially determined contribution requirement beginning February 1, 1997 of $263 thousand with a targeted 15 year funding assumption for fiscal year 1997-98.

CPS contributions amounted to 10.0 percent of covered payroll in 1998; 11.4 percent in 1997; and 12.2 percent in 1996. Of the amounts contributed during years 1998, 1997, and 1996, approximately $15.3 million, $14.7 million, and $13.9 million, respectively, was to fund the normal costs of the Plan each year. The remaining contribution in each year was to fund the amortization of the unfunded actuarial accrued liability.

Effective with the fiscal year ending January 31, 1998, CPS has elected to implement GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, which supersedes GASB Statement No. 5, Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers. A schedule of funding progress under GASB Statement No. 27 guidelines follows:

	Actuarial Valuation Date		
	1/1/97	1/1/96	1/1/95
		(In millions)	
1. Actuarial Value of Assets	$455.6	$406.0	$361.6
2. Actuarial Accrued Liability(AAL)	487.2	455.3	423.3
3. Unfunded AAL (UAAL): (2) -(1)	31.6	49.3	61.7
4. Funded Ratio (1)÷(2)	93.5%	89.2%	85.4%
5. Covered Payroll	123.8	125.2	115.6
6. UAAL as a Percentage of Covered Payroll: (3)÷(5)	25.5%	39.4%	53.4%

Methods used for the January 1, 1997 actuarial valuation include (a) the five-year smoothed market method for asset valuation, (b) the projected unit credit for pension cost, and (c) the level dollar for amortization. The remaining amortization period is 16.52 years and is calculated using the level dollar open amortization method.

Significant actuarial assumptions used for the January 1, 1997 actuarial valuation include (a) a rate of return on the investment of present and future assets of 8.5% per year compounded annually, (b) projected salary increases averaging 5.0%, and (c) post-retirement cost-of-living increases of 2.0%. The projected salary increases include an inflation rate of 4.0%.

Calculated under GASB Statement No. 27 guidelines, CPS' Annual Required Contribution (ARC), which is equivalent to the Annual Pension Cost, was $12.2 million for fiscal year ended January 31, 1998. Employer contributions in relation to ARC were also $12.2 million with a resulting net pension obligation at year end of $0.

Prior year information is reported under GASB Statement No. 5. This statement requires that a pension benefit obligation be measured using the actuarial present value of credited projected benefits, as adjusted for projected salary increases. This measure is independent of the funding method used to determine contributions to the Plan; however, the significant actuarial assumptions used to compute the contribution requirement are the same as those used to compute the pension benefit obligation.

Under GASB Statement No. 5, the following represents CPS' pension benefit obligation (in thousands) as of December 31, 1996:

	1996
For retirees, beneficiaries and inactive Participants	$194,061
For active participants:	
Employer and employee-financed vested benefits	240,115
Employer-financed nonvested benefits	53,030
Total pension benefit obligation	487,206
Net assets available for plan benefits (at fair market value)	515,036
Overfunded pension benefit obligation	$ (27,830)

Net assets available for plan benefits were 105.7 percent of total pension benefit obligation in 1996. Net assets exceeded the pension benefit obligation for 1996 by 22.2 percent of covered payroll.

Employees who retired prior to 1983 are receiving annuity payments from an insurance carrier as well as receiving some benefits directly from CPS. CPS costs for fiscal 1998 and 1997 were $425 thousand and $447 thousand respectively, and were recorded when paid.

Deferred Compensation Plan

CPS offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan receives no contributions from CPS. It is available to all CPS employees and permits them to defer a portion of their salary until future years. Funds are managed by independent fund managers. The deferred compensation is not available to employees until termination, retirement, or death, or due to an unforeseeable emergency.

As a result of the Small Business Job Protection Act of 1996 (the Act), certain provisions of the Internal Revenue Code 457 have been amended that are applicable to CPS' deferred compensation plan. Under the amended provisions, all assets of the plan are to be held in a trust for the exclusive benefit of participants and their beneficiaries; however, the assets do not have to be placed in a trust until January 1, 1999. In February 1998, CPS trustees approved the amendment and restatement of the deferred compensation plan to provide that two trusts hold all assets of the plan for the exclusive benefit of the participants and beneficiaries.

7. Other Postemployment Benefits

CPS provides certain health care and life insurance benefits for retired employees. All former CPS employees are eligible for these benefits upon retirement from CPS. Plan assets are held as part of CPS' Group Health and Life Plans. Plan funding 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 Plans may be amended by CPS, acting by and through the General Manager of CPS. The annual cost of retiree health care and life insurance benefits funded by CPS is recognized as an expense of CPS as employer contributions are made to the programs. These costs approximated $2.5 million and $2.4 million for 1998 and 1997, respectively. CPS reimbursed $43.80 per month for Medicare supplement for certain retirees and their spouses enrolled in Medicare Part B in 1998.

Retired employees and covered dependents contributed $974 thousand and $925 thousand for their health care and life insurance benefits in fiscal 1998 and 1997, respectively. In fiscal 1998, there were approximately 1,750 retirees and covered dependents eligible for health care and life insurance benefits, as compared to approximately 1,734 in 1997.

In view of the potential economic significance of these benefits, CPS has reviewed the present value of the postemployment benefit obligations for current retirees. The January 1, 1997, valuations are $38.4 million for health and $14.9 million for life insurance benefits. The actuarial analysis of the present value of postemployment benefit obligations for other participants fully eligible for benefits are estimated to be $31.9 million for health, $4.3 million for life insurance and $2.1 million for disability benefits. CPS began partial accrual and funding of projected future benefits in 1992. Funding totaled $5.4 million in fiscal 1998, $5.0 million in 1997, $7.0 million per year in 1996, and $5.0 million per year for 1993 through 1995.

For the health plan, the actuarial cost method used is the Projected Unit Credit Actuarial Cost Method. For the life insurance and disability plans, CPS uses a present value method to determine the cost of benefits.

Significant actuarial assumptions used in the calculations for the January 1, 1997 actuarial valuations include (a) a rate of return on the investment of present and future assets of 8.5% per year for the health and life plans and 7% per year for the disability, (b) projected salary increases for the plans ranging from 3.3% to 12.0% depending on age for base and other salaries, and (c) medical cost increases projected at 8% for 1998 and 7% thereafter.

8. Payments to the City

The New Series Bond Ordinances provide for benefits and services totaling 14 percent of CPS gross revenues, as defined, to be paid or provided to the City. The Old Series Trust Indenture, which terminated at the end of fiscal 1997, also included a tax equivalent payment.

Gross revenue for 1998 and 1997 (in thousands) was as follows:

	1998	1997
Electric revenue	$ 844,848	$ 841,699
Gas revenue	137,593	147,980
Interest and other income	49,761	34,636
Gross revenue	$ 1,032,202	$ 1,024,315

Payments to the City for 1998 and 1997 (in thousands), as defined, were as follows:

	1998	1997
Tax equivalent	$ —	$ 15,154
Refund gas and electric services	17,121	17,109
Additional cash payments	121,422	105,325
Total payments to the City	$ 138,543	$ 137,588

9. South Texas Project (STP)

CPS is one of four participants in the STP, which consists of two 1,250-megawatt nuclear generating units in Matagorda County, Texas. The other participants in the project are the project manager, Houston Lighting & Power Company (HL&P), Central Power and Light Company (CPL), and the City of Austin (Austin). Full power operating licenses were issued by the Nuclear Regulatory Commission (NRC) on March 22, 1988, for Unit 1 and March 28, 1989, for Unit 2. In-service dates for STP were August 1988 for Unit 1 and June 1989 for Unit 2. CPS' 28-percent ownership in the STP represents 700 megawatts of plant capacity. At January 31, 1998, CPS' investment in the STP utility plant was approximately $1.7 billion, net of accumulated depreciation.

As a result of litigation settlements between HL&P and the other owners, the participants agreed to create a new operating company which would replace HL&P as Project Manager for the maintenance and operation of STP. Effective November 17, 1997, the Participation Agreement among the owners of STP was Amended and Restated and the STP Nuclear Operating Company, a Texas non-profit non-member corporation created by the participants, assumed responsibility as the licensed operator of STP. The participants continue to share costs in proportion to ownership interests, including all liabilities and expenses of STP Nuclear Operating Company.

LITIGATION — CPS and HL&P entered into a joint operations agreement in June 1996 which resolved CPS' claims against HL&P concerning the shutdown of the STP nuclear plant during fiscal 1994 and cost overruns during the STP construction period. The total value of the settlement was projected to be $225 million over a ten-year period.

CPS received an initial $75 million in cash proceeds during the summer of fiscal 1997, of which $11 million was used to reimburse CPS for litigation expenses incurred. The remaining $64 million was directly refunded to the ratepayers during September 1996.

The settlement also included an arrangement to jointly dispatch CPS' and HL&P's generating plants to take advantage of the most efficient plants and favorable fuel prices of each utility. This joint operations agreement must result in at least $10 million in cumulative savings per year to CPS, or HL&P will make up the difference in cash. A similar payment will be made by HL&P to ensure benefits to CPS of $150 million in savings during the ten-year life of the joint operating agreement. As of January 31, 1998, CPS' total cumulative share of the savings totaled $32.5 million.

NUCLEAR INSURANCE — The Price-Anderson Act, a comprehensive statutory arrangement providing limitations on nuclear liability and governmental indemnities, is in effect until August 1, 2002. The limit of liability under the Price-Anderson Act for licensees of nuclear power plants is $8.92 billion per incident. The maximum amount that each licensee may be assessed following a nuclear incident at any insured facility is $75.5 million, which may be adjusted for inflation, for each licensed reactor, payable at $10 million per year per reactor for each nuclear incident. CPS and each of the other participants of STP are subject to such assessments. CPS and the other participants have agreed that any such assessments will be borne on the basis of their respective ownership interests in STP. CPS' ownership interest in STP is 28 percent. 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 $400 million for the nuclear industry as a whole, provides protection from nuclear-related claims of workers employed in the nuclear industry after January 1, 1988 who do not use the workers' compensation system as sole remedy and bring suit against another party. STP could be assessed up to approximately $3.9 million to pay its share for this liability coverage during the life of the plant.

NRC regulations require licensees of nuclear power plants to obtain on-site property damage insurance in a minimum amount of $1.06 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 $2.75 billion of nuclear property insurance, which is above the legally required amount of $1.06 billion, but is less than the total amount available for such losses. The $2.75 billion of nuclear property insurance consists of $500 million in primary property damage insurance, along with $2.25 billion of excess property damage insurance that is subject to a retrospective assessment being paid by each electric utility which is a member of Nuclear Electric Insurance Limited (NEIL). In the event that property losses as a result of an accident at the nuclear plant of any utility insured by NEIL exceed the accumulated fund available to NEIL, a retrospective assessment could occur. The maximum aggregate assessment under current policies is $11.5 million during any one policy year.

NUCLEAR DECOMMISSIONING — In July 1990, CPS, together with the other owners of the STP, filed with the NRC a certificate of financial assurance for the decommissioning of the nuclear power plant. The certificate assures that CPS will 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 1994, the owners conducted a review of decommissioning costs. The results estimated CPS' share of decommissioning costs at approximately $270 million in 1994 dollars, which also exceeded NRC minimum requirements.

In 1991, CPS started accumulating the decommissioning funds in an external trust, in accordance with the NRC's regulations. The trust accounts and related decommissioning liability are not included in CPS' financial statements. At January 31, 1998, CPS has accumulated approximately $72.8 million of decommissioning funds in the external trust. Based upon the 1994 decommissioning cost study, the annual levelized funding was $8.8 million for both 1998 and 1997.

10. Commitments and Contingencies

In the normal course of business, CPS is involved in other legal proceedings related to alleged personal and property damages, breach of contract, condemnation appeals and discrimination cases. In addition, CPS power generation activities and other utility operations are subject to extensive state and federal environmental regulation. In the opinion of management of CPS, the outcome of such proceedings will not have a material adverse effect on the financial position or results of operations of CPS.

CPS is exposed to various risks of loss including those related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. CPS purchases commercial liability and property insurance coverages to provide protection in event of large/catastrophic claims. In addition, CPS is exposed to risks of loss due to death, injuries to, and illnesses of, its employees. CPS makes payments to external trusts to cover the claims under the related plans. At January 31, 1998, CPS has accumulated approximately $93.9 million of funds in these external trusts. The trust accounts and related claims liabilities are not included in CPS' financial statements. CPS has recorded $13.5 million of expense related to these plans for the year ended January 31, 1998.

Purchase and construction commitments amounted to approximately $1.2 billion at January 31, 1998. This amount includes approximately $608 million that is expected to be paid for natural gas purchases to be made under the contract currently in effect through the year 2002; the actual amount to be paid will be dependent upon CPS' actual requirements during the contract period and the price of gas. Commitments also include $72 million for pipeline quality gas to be produced from the City of San Antonio "Nelson Gardens" landfill under the contract which is currently in effect through the year 2017. Also included is $28 million for coal purchases through 2000, $169 million for coal transportation through 2004, and $12 million for treated cooling water through 2005, based upon the minimum firm commitment under these contracts.

Additional purchase commitments at January 31, 1998 which are related to STP include approximately $11.8 million for raw uranium and associated fabrication and conversion services. This amount represents services that will be needed for future refuelings during the next two fiscal years.

The Public Utility Commission (PUC) of Texas has promulgated new rules designed to comply with legislative changes affecting the utility industry. The Transmission Pricing and Access Rule (Rule) mandates that electric utilities charge customers for wholesale open transmission access according to a formula based 70 percent on a single state-wide fee and 30 percent on the calculated economic impact of open access on each electric utility in Texas. This rate structure potentially will cost CPS $15 million per year in additional transmission costs that will effectively subsidize competing utilities with higher transmission costs. The PUC's Rule includes a rate-moderation plan that will minimize the impact of the new pricing mechanism for the first three years that the Rule is in effect. Under this plan, CPS' costs for calendar year 1997 were 10 percent of the total cost mentioned above; costs for 1998 and 1999 will be 20 percent and 30 percent of the above cost, respectively. The total amount of $1.8 million recorded in the 1998 financial statements includes an estimated amount for January 1998.

Last year, CPS petitioned the PUC to amend the Rule and challenged the Rule's validity in State District Court. CPS also filed an appeal from the PUC's determination as to the level of transmission costs CPS may recover under the PUC's Rule. CPS is currently appealing the State District Court's opinion upholding the Rule's validity.

The ultimate effect of the Rule and other developments in the restructuring of the electric industry is unknown at this time. CPS is continuously monitoring developments as it positions itself to maximize potential benefits and mitigate detrimental effects where possible.

11. Segment Information

	1998			1997		
	Electric	Gas	Total	Electric	Gas	Total
		(In thousands)			(In thousands)	
OPERATING REVENUE	$ 844,848	$ 137,593	$ 982,441	$ 841,699	$ 147,980	$ 989,679
EXPENSES:						
Operating and maintenance expenses	394,768	95,194	489,962	379,219	109,133	488,352
Regulatory transition assessment	1,851		1,851	—	—	
Depreciation	142,223	11,184	153,407	136,343	10,216	146,559
Tax equivalent to City of San Antonio	—	—	—	11,793	3,361	15,154
Total expenses	538,842	106,378	645,220	527,355	122,710	650,065
OPERATING INCOME	$ 306,006	$ 31,215	337,221	$ 314,344	$ 25,270	339,614
Interest and other income			49,761			34,636
Net interest and debt expense			(184,055)			(179,163)
INCOME BEFORE OPERATING TRANSFERS			202,927			195,087
Payments to the City's General Fund			(138,543)			(122,434)
NET INCOME			$ 64,384			$ 72,653
CAPITAL EXPENDITURES	$ 152,454	$ 43,302	$ 195,756	$ 131,777	$ 40,491	$ 172,268
ASSETS:						
Plant in service, net of accumulated depreciation:						
Production - all STP facilities	$1,654,579		$1,654,579	$1,715,906		$1,715,906
Production - other facilities	685,793		685,793	698,015		698,015
Transmission facilities	188,684		188,684	182,574		182,574
Distribution facilities	707,146	$ 225,323	932,469	654,975	$ 198,271	853,246
General facilities	39,106	13,021	52,127	38,216	13,393	51,609
Subtotal net plant in service	3,275,308	238,344	3,513,652	3,289,686	211,664	3,501,350
Identifiable construction work in progress	121,231	10,992	132,223	117,922	17,422	135,344
Nuclear fuel, net of accumulated amortization	44,251		44,251	54,256		54,256
Held for future use	31,384		31,384	31,384		31,384
Total identifiable utility plant	$3,472,174	$ 249,336	3,721,510	$3,624,411	$ 241,652	3,722,334
Net common utility plant and common CWIP			179,245			143,729
Total net utility plant			3,900,755			3,866,063
Other identifiable assets	$ 169,821	$ 16,638	186,459	$ 158,246	$ 21,622	179,868
Total identifiable assets and common plant/CWIP			4,087,214			4,045,931
Unidentifiable assets			945,376			568,853
TOTAL ASSETS			$5,032,590			$4,614,784
TOTAL EQUITY AND LIABILITIES			$5,032,590			$4,614,784
NET WORKING CAPITAL			$ 82,355			$ 17,656

INDEPENDENT AUDITORS' REPORT

The Board of Trustees
City Public Service:

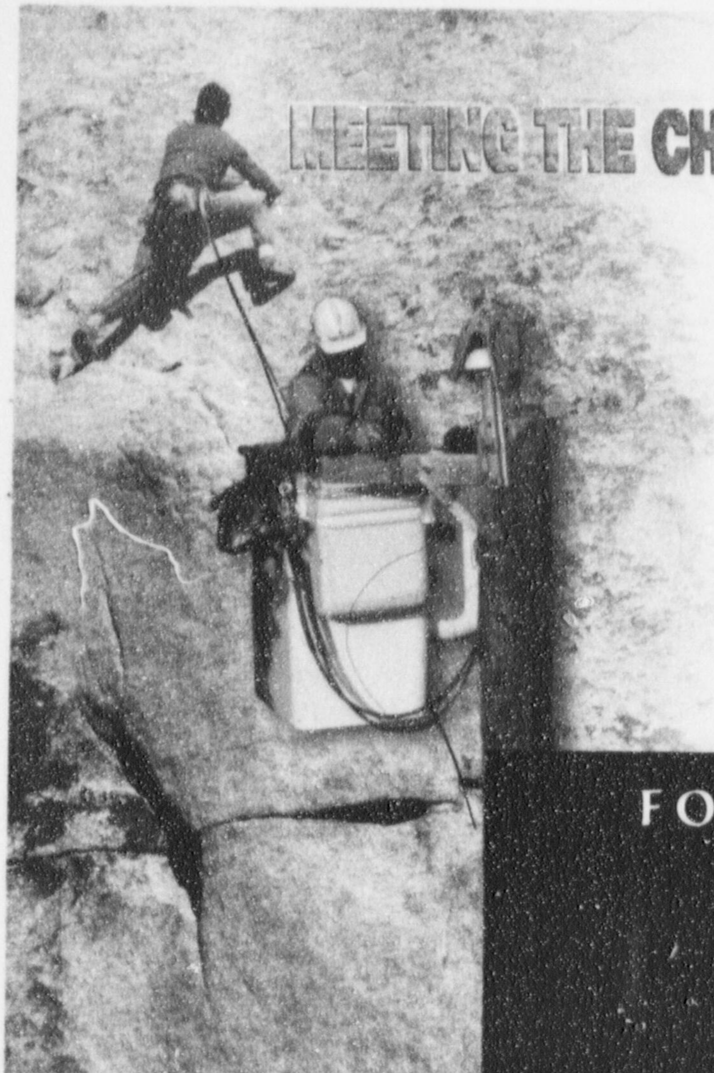
We have audited the accompanying balance sheet of City Public Service, a component unit of the City of San Antonio, Texas, as of January 31, 1998, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the year then ended. These financial statements are the responsibility of City Public Service's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of City Public Service Employees' Pension Plan. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion on the City Public Service financial statements, insofar as it relates to the amounts included for the City Public Service Employees' Pension Plan, is based on the report of the other auditors. The financial statements of City Public Service as of January 31, 1997, were audited by other auditors whose report dated March 14, 1997, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of City Public Service as of January 31, 1998, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

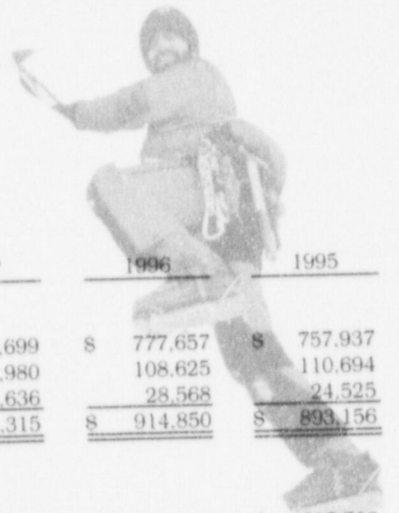
KPMG Peat Marwick LLP   Leal & Carter, P.C.   Robert J. Williams CPA

San Antonio, Texas
March 16, 1998


MEETING THE CHALLENGE


FOR SAN ANTONIO

FIVE YEAR FINANCIAL REVIEW – UNAUDITED



Years Ended January 31,
(In thousands)

	1998	1997	1996	1995	1994
GROSS REVENUE AND APPLICAT[illegible]					
Gross Revenue:					
Electric revenue	$ 844,848	$ 841,699	$ 777,657	$ 757,937	$ 781,661
Gas revenue	137,593	147,980	108,625	110,694	125,491
Interest and other income	49,761	34,636	28,568	24,525	23,353
Gross revenue	$ 1,032,202	$ 1,024,315	$ 914,850	$ 893,156	$ 930,505
Gross Revenue applied:					
Costs of operating the systems:					
Fuel, purchased power and resale gas	$ 256,836	$ 255,055	$ 203,337	$ 210,503	$ 260,215
Other operating and general expenses	157,291	161,874	172,745	164,885	166,054
Maintenance	75,835	71,423	78,632	72,848	88,528
Total	$ 489,962	$ 488,352	$ 454,714	$ 448,236	$ 514,797
Regulatory transition assessment *	$ 1,851	—	—	—	—
Debt requirements for Old Series Bonds : **					
Interest expense	—	$ 945	$ 1,838	$ 2,678	$ 3,390
Principal requirements	—	12,567	12,840	12,235	13,112
Reserve requirements	—	(16,639)	(87)	(327)	(346)
Total		$ (3,127)	$ 14,591	$ 14,586	$ 16,156
Payments to the City's General Fund:					
Tax equivalent to City of San Antonio	$	$ 15,154	$ 13,696	$ 12,736	$ 11,817
Refunds for services	17,121	17,109	16,587	16,163	16,464
Additional payment	121,422	105,325	92,639	90,953	96,601
Total	$ 138,543	$ 137,588	$ 122,922	$ 119,852	$ 124,882
Debt requirements for New Series Bonds & Other:					
Interest expense	$ 131,529	$ 128,581	$ 127,268	$ 129,899	$ 150,588
Principal requirements	62,306	75,207	69,067	64,597	66,460
Reserve requirements **	(7,591)	16,227	(621)	1,150	1,239
Commercial paper debt service	15,841	22,975	23,746	22,795	8,429
Other interest and debt expense	1,190	6,667	6,287	3,739	3,300
Total	$ 203,275	$ 249,657	$ 225,747	$ 222,180	$ 230,016
Revenue available for construction and other business strategies	$ 198,571	$ 151,845	$ 96,876	$ 88,302	$ 44,654
Total application	$ 1,032,202	$ 1,024,315	$ 914,850	$ 893,156	$ 930,505
ADDITIONS TO PLANT AND NET REMOVAL COSTS					
Net cash expenditures	$ 199,457	$ 168,472	$ 164,455	$ 148,333	$ 123,396
Interest during const[illegible]action	4,743	3,654	2,818	3,072	1,977
Total expenditures	$ 204,200	$ 172,126	$ 167,273	$ 151,405	$ 125,373
Funding for expenditures:					
Bond proceeds	$ 152,753	$ 57,157	$ 16,109	$ 0	$ 0
Revenue from operations	39,555	108,041	110,104	60,726	64,483
Commercial paper proceeds	4,500	0	33,299	81,278	53,811
Customer contributions and other proceeds	7,392	6,928	7,761	9,401	7,079
Total funding	$ 204,200	$ 172,126	$ 167,273	$ 151,405	$ 125,373
BALANCE SHEET DATA					
Bond principal and interest coverage	2.79x	2.47x	2.18x	2.12x	1.78x

* *The Regulatory Transition Assessment for 1998 reflects the cumulative effect of the fiscal year's Public Utility Commission transmission access charges. This is the first year CPS has incurred such expense.*

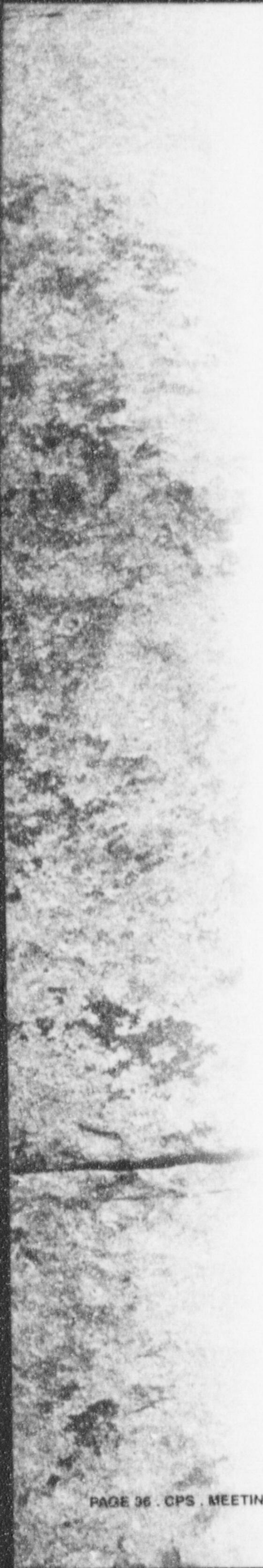
** *The Old Series Bonds were fully defeased as of February 1, 1997 and at that time, the provisions set forth by the New Series Bond Ordinance became effective. The Old Series Bonds Reserve Requirements for 1997 reflects a transfer of the remaining assets of $16,552 to the New Series Reserve.*

FIVE YEAR OPERATIONS REVIEW – UNAUDITED

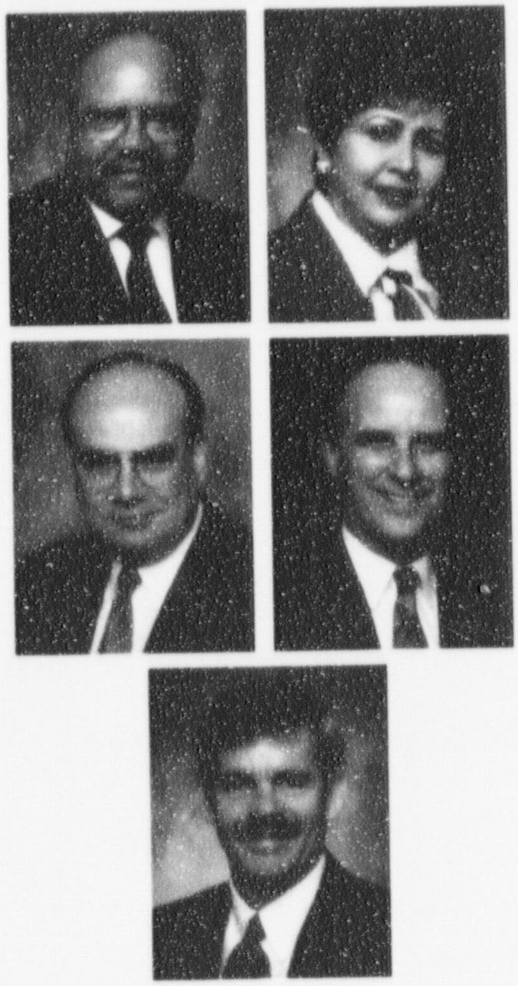
Years Ended January 31,
(In thousands)

	1998	1997	1996	1995	1994
OPERATING REVENUE					
Electric:					
Residential	$ 392,889	$ 398,061	$ 360,484	$ 346,396	$ 350,583
Commercial and industrial	329,241	322,595	304,090	301,319	315,156
Street lighting	11,404	11,073	10,762	10,454	10,468
Public Authorities	87,198	85,488	80,812	78,504	86,370
Sales for resale	11,731	11,268	9,966	9,316	9,611
Off-system sales *	6,667	6,828	5,580	5,923	3,958
Miscellaneous	5,718	6,386	5,963	6,025	5,516
Total electric	$ 844,848	$ 841,699	$ 777,657	$ 757,937	$ 781,662
Gas:					
Residential	$ 79,791	$ 87,362	$ 65,668	$ 65,965	$ 75,708
Commercial and industrial	47,547	50,360	36,305	37,982	41,94[illegible]
Public Authorities	9,197	9,284	5,763	5,824	6,905
Miscellaneous	1,058	974	889	923	934
Total gas	$ 137,593	$ 147,980	$ 108,625	$ 110,694	$ 125,491
SALES (In thousands)					
Electric — KWH:					
Residential	5,990,225	6,142,014	5,606,699	5,287,483	5,005,292
Commercial and industrial	6,467,755	6,409,608	6,090,667	5,881,461	5,604,418
Street lighting	97,775	97,339	95,428	92,392	90,619
Public Authorities	1,972,320	1,946,948	1,854,042	1,765,728	1,668,884
Sales for resale	287,996	290,265	261,325	235,900	213,765
Off-system sales *	351,745	381,331	347,129	236,964	142,399
Total	15,167,816	15,267,505	14,255,290	13,499,928	12,725,377
Gas — MCF:					
Residential	13,607	13,752	12,902	12,488	13,921
Commercial and industrial	10,875	10,963	10,683	10,566	10,584
Public Authorities	2,293	2,071	1,718	1,639	1,803
Total	26,775	26,786	25,303	24,693	26,308
PURCHASE FOR RESALE:					
Electric (1000) KWH**	0	52,450	345,107	327,082	70,977
Gas (1000) MCF	26,308	27,673	25,927	24,975	27,112
ELECTRIC GENERATION — (1000) KWH * & ***	15,738,497	15,659,321	14,764,596	13,945,516	13,431,946
Electric Gen. Capacity, KW (Gas)	2,430,000	2,430,000	2,430,000	2,400,000	2,400,000
Electric Gen. Capacity, KW (Coal)	1,385,000	1,385,000	1,385,000	1,336,000	1,336,000
Electric Gen. Capacity, KW (Nuclear)	700,000	700,000	700,000	700,000	700,000
ELECTRIC PEAK DEMAND — KW	3,448,000	3,356,000	3,249,000	3,052,000	2,908,000
NUMBER OF CUSTOMERS:					
Electric	539,400	528,739	519,269	506,646	494,385
Gas	301,181	300,185	299,167	296,200	292,241
RESIDENTIAL AVERAGES:					
Electric:					
Revenue per customer	$ 833.89	$ 862.33	$ 799.26	$ 786.61	$ 814.44
KWH per customer	12,714	13,306	12,431	12,007	11,628
Revenue per KWH	6.56¢	6.48¢	6.43¢	6.55¢	7.00¢
Gas:					
Revenue per customer	$ 284.93	$ 313.44	$ 237.20	$ 240.75	$ 279.13
MCF per customer	48.6	49.3	46.6	45.6	51.3
Revenue per MCF	$ 5.86	$ 6.35	$ 5.09	$ 5.28	$ 5.44

**1998 and 1997 include $310 thousand and 137,600 MWH and $150 thousand and 66,110 MWH, respectively, of Fuel-Supplied energy transactions with a wholesale customer.*
***1998 and 1997 does not include 29,566 MWH and 385,657 MWH, respectively, of generation provided to CPS as part of the Joint Systems Operating Agreement.*
****1998 and 1997 does not include 3,114,333 MWH and 2,259,699 MWH, respectively, of generation provided to HL&P as part of the Joint Systems Operating Agreement.*



CPS Board of Trustees



CPS Management Staff

Arthur von Rosenberg
General Manager

Kenneth J. Fiedler
Assistant General Manager for Customer and Distribution Services

Joe O. Treviño
Assistant General Manager for System Engineering and Engineering Services

Jamie A. Rochelle
Assistant General Manager for Corporate Services and Finance

William C. Gunst
Senior Manager for Production

CPS Department Managers

Ralph E. Alonzo
Customer Services

Les Barrow
Distribution

Steven Braimer, Jr.
Administrative Services

Nelson A. Clare
Legal Services

Martin Clausewitz
Generation Control and Marketing

Anthony C. Edwards
Human Resources

Lou Fleckenstein
Materials Management

Nick Flores
Underground Engineering & Metering

Paul Garza
Field Administration

Wallace H. Geissler
Fuels

Leonard Hill
Transmission and Distribution Engineering

Cy Hutchinson
Information and Communication Services

John J. Leal
Workforce Policy and Planning

Donald R. Schnitz
Gas

Barbara K. Stover
Public Relations and Marketing

Donald S. Thomas
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