

General Manager's Overview

The Austin Electric Utility is in a state of transition. The Austin Electric Utility is engaging in initiatives to aggressively meet the increasing competition in the electric utility industry. These initiatives will move us toward our vision that the citizen-owners of the Austin Electric Utility view us as a competitive, full-service provider of comfort, convenience, safety products and services, and the cornerstone of all of Austin's utilities. We add outstanding value to our community and ensure that Austin is a sustainable city.

To achieve our vision, we will focus on five goals/issues:

- System Reliability
- Competitive Rates and Bills
- Profitability
- Customer Satisfaction
- Employee Satisfaction

City Council Direction

In December, 1996, the City Council adopted a policy resolution which set guidelines and financial targets for enhancing the competitive position of its electric utility. The major components of the resolution and the current status of our initiatives are:

Resolution Item 1

- The City will achieve competitive prices for its electric utility for all customer classes by the year 2002 using the annual ERCOT average retail price as a standard. The City will continue efforts to retain major retail customers.

Status: The Austin Electric Utility is continuing to focus on providing competitive prices by the year 2002. As part of this initiative, the City Council approved the negotiation of special rates for our large customers if they agreed to remain our customer on a long term basis. IBM, Motorola, AMD and Seton have already signed contracts with our utility.

The approved FY1998 budget does not include any changes to our current rates. The updated forecast achieves the City Council goal of reducing the average cost per kWh one cent in FY2002 and an additional one cent in FY2005.

Resolution Item 2

- The City Manager will annually present to the City Council a review of utility operations and finances and the progress of deregulation, including legislation. The City Manager will also produce a detailed analysis of the utility's projected competitive position and recommend, based on this analysis, the annual allocation of utility revenue to its debt management fund. The City Council will use this recommendation in determining the general fund transfer and the utility's budget.

Status: This budget document contains a discussion on deregulation and regulatory updates, the recommended allocation to the debt management fund, the general fund transfer, and the utility's budget.

Resolution Item 3

- The City will direct all excess electric utility cash to a debt management fund to be used to improve the competitive position of its electric utility by reducing debt and improving the debt to capital ratio as shown below. The City will provide for future customer requirements from purchased power and demand side management programs.

Debt as % of Capital				
FY97	FY98	FY99	FY00	FY01
75%	73%	70%	66%	64%

Status: The debt management fund is projected to increase from \$101 million in FY1997 to \$145 million in FY1998. Savings from reduced operating costs and increased revenues have been allocated to the debt management fund. Projected Debt as a percent of Capital ratios have improved slightly over the targeted ratios. New projections for the period are as follows:

Debt as % of Capital				
FY97	FY98	FY99	FY00	FY01
75%	72%	69%	65%	62%

Austin Electric Utility is developing a plan to provide for future customer requirements from purchased power and demand side management programs.

Resolution Item 4

- The City will continue to reduce operating expenses for its electric utility, summarized as follows:

Total O&M (cents/kWh)				
FY97	FY98	FY99	FY00	FY01
3.367	3.160	3.090	2.950	2.810

Status: With the assistance of Metzler & Associates, we are continuing to work on initiatives to lower our O&M cost per kWh. Since approval of the December, 1996 resolution, two significant expense items have been added to our O&M expense.

The first item is additional fuel expense for outside sales to other customers. This reflects a more aggressive power marketing effort as recommended by Metzler. The fuel expense is offset by fuel revenue, and profits on the sales are reflected in additional base revenue. The result is additional revenue and a lower O&M cost per kWh beginning in FY1998 as expenses are spread over additional kWh.

The second item is transmission expense. This item recognizes new charges adopted by the Public Utility Commission of Texas (PUCT) for use of transmission facilities. An Independent System Operator was established last year to govern wholesale open access on the Electric Reliability Council of Texas (ERCOT) transmission system. Austin Electric Utility will be billed for transmission services provided by other Texas utilities for its use of the ERCOT transmission system. These charges will result in higher O&M expenses. Austin Electric Utility will also bill other Texas utilities for transmission services. These billings will produce revenue to more than offset the charges to Austin, resulting in a net profit to Austin Electric Utility. As a result of this additional expense, we will slightly exceed our target in FY1997. However, the expenses are more than offset by additional revenue, resulting in a positive benefit to the ratepayer.

The following tables compare the original O&M targets in the resolution to projected O&M for the period FY1997 through FY2001:

Targeted Total O&M (cents/kWh)				
FY97	FY98	FY99	FY00	FY01
3.367	3.160	3.090	2.950	2.810

Projected Total O&M (cents/kWh)				
FY97	FY98	FY99	FY00	FY01
3.550	2.701	2.784	2.889	2.885

Resolution Item 5

- The City will initiate a public education and input process that may culminate in a City Charter amendment election to consider governance options for its electric utility, including establishing a partial powers governing board using the San Antonio model. This board model will retain for City Council the powers of eminent domain, rate setting, debt issuance, and budget approval.

Status: A decision on a possible charter election, and items to be included, will be determined by the City Council.

Resolution Item 6

- The City Council will decrease the General Fund Transfer from its electric utility, as indicated below, as necessary to achieve competitive pricing for its electric utility using the annual ERCOT average retail price as a standard, with an annual review to reaffirm the appropriate level as the competitive market develops.

Percent of Total Revenue				
FY97	FY98	FY99	FY00	FY01
10.6%	10.1%	9.1%	8.1-8.5%	6.6-8.2%

Status: Targets are being met over the forecast period. Based on the FY1997 estimate, the general fund transfer as a percent of total revenue for FY1997 was 10.5%, or \$57,180,100. The approved general fund transfer as a percent of total revenue for FY1998 is 10.1%, or \$57,409,800.

Resolution Item 7

- The City will reduce conservation spending for its electric utility over a five year period as shown below, as necessary to achieve competitive pricing for its electric utility using the annual ERCOT average retail price as a standard, with an annual review to reaffirm the appropriate level as the competitive market develops. The City will evaluate conservation programs on an ongoing basis to ensure that they are achieving maximum savings and effectiveness.

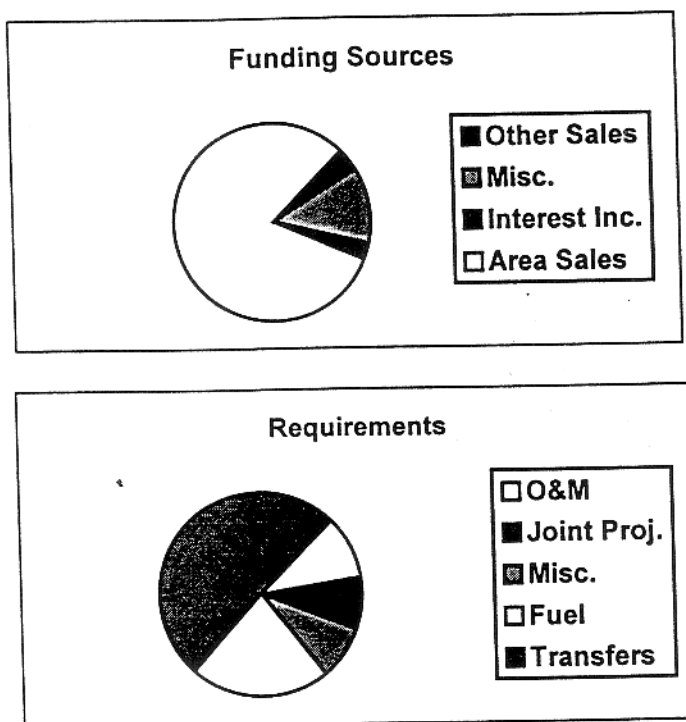
Total Budget (\$ millions)				
FY97	FY98	FY99	FY00	FY01
\$13.4	\$12.9	\$12.4	\$11.9	\$11.4

Status: Approved conservation funding for FY1998 is \$14.4 million. However, the targets for the remaining forecast period have not changed.

Operating and Maintenance Budget

The approved FY1998 Operating and Maintenance Budget, including all transfers and debt service, totals \$680.3 million, a decrease of \$12.3 million from the FY1997 current year estimate. The approved budget includes a reduction of 77.35 vacant positions. When combined with the FY1997 reductions, 156.75 vacant positions have been eliminated in two years, resulting in an overall 12% reduction in positions.

Funding sources and requirements for the Operating and Maintenance budget are illustrated on the following charts:

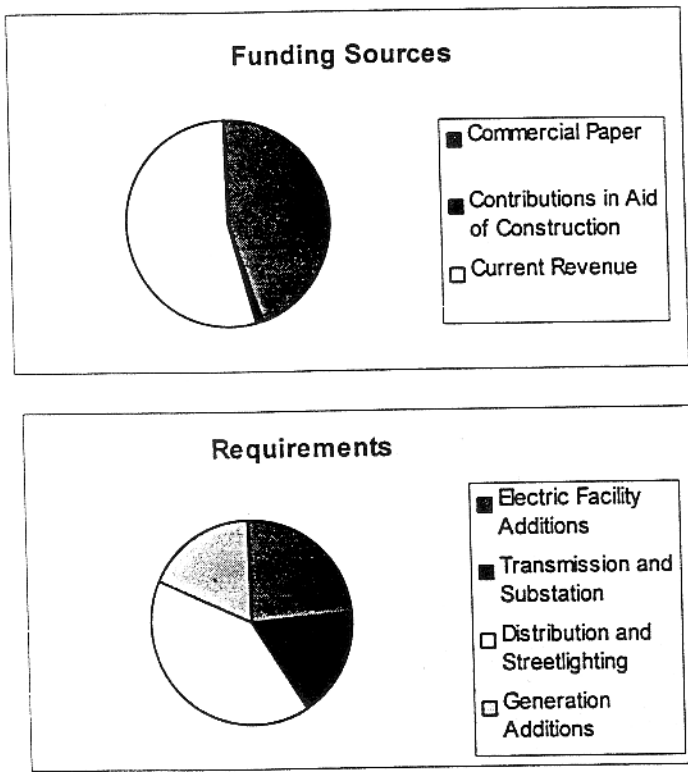


Capital Improvement Plan Budget

The approved Capital Improvement Plan (CIP) spending requirements total \$93.5 million, a decrease of \$7.5 million from the FY1997 current year estimate. Previously approved appropriations in the amount of \$30.8 million will be used to fund a portion of the spending plan for FY1998. New appropriations approved for FY1998 include:

- \$10 million for electric facility additions
- \$9.5 million for transmission and substation additions
- \$36.4 million for distribution systems and streetlighting
- \$6.8 million for generation additions

Funding sources and requirements for the Capital Improvement Plan are illustrated on the following charts:



An important change in the approved CIP is the increase in the FY1998 CIP Transfer. The transfer is increasing from \$43.8 million in FY1997 to \$50.7 million in FY1998. A higher transfer results in less debt being issued to meet capital requirements. Lower debt is a key strategy in moving to a more competitive position.

Major Changes

Several major changes have been implemented for this fiscal year to move us to a more competitive position or as a result of recent legislation.

- Utility Customer Service Office (UCSO) has moved from the City's Financial Services Department to the Austin Electric Utility.
- Transmission Expenses and Revenues are included in the approved budget as previously discussed.
- Austin Electric Utility will transfer \$6,698,000 to the Performance Contract Fund in FY1998 to finance performance contracting services with small and medium size, under-served commercial customers and government facilities. This transfer will provide the initial funding for an Energy Services Unit in the Planning, Environmental and Conservation Services Department (PECSD).

Key Initiatives

The Austin Electric Utility will be working on many key initiatives to move us toward a more competitive position. The categories and the associated key initiatives are listed below:

Generation

- ⇒ Asset Valuation
- ⇒ Long-term Generation Option Analysis
- ⇒ Expand Sales of Surplus Energy
- ⇒ Inventory Reduction
- ⇒ Joint Projects Cost Reduction

Transmission and Distribution

- ⇒ Commodity Sourcing Teams
- ⇒ Distribution Performance Management System
- ⇒ Geographic Information System (GIS)
- ⇒ Electrical System Re-Rating
- ⇒ Work Management System
- ⇒ Major Projects Development Process
- ⇒ Activity Based Management System
- ⇒ Develop Customer Service Standards
- ⇒ Right-size Transmission & Distribution Fleet

Marketing

- ⇒ Develop Strategic Marketing Plan
- ⇒ Develop Marketing Performance Reporting
- ⇒ Develop Energy Services Unit
- ⇒ Restructure Marketing Department

Customer Service

- ⇒ Consolidate Customer Call Center
- ⇒ Replace Meter Reading System
- ⇒ Implement New Customer Information System
- ⇒ Reduce Accounts Receivable Delinquencies

Finance

- ⇒ Re-engineer Finance/Accounting
- ⇒ Develop Financial Performance Reporting System
- ⇒ Implement Activity Based Management System

Business Services

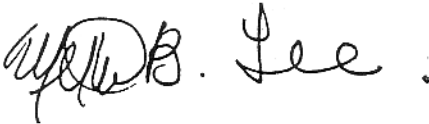
- ⇒ Re-engineer Facilities Management
- ⇒ Develop Strategic Information System Plan
- ⇒ Re-engineer Purchasing
- ⇒ Re-engineer Information System Process
- ⇒ Re-engineer Fleet Management

Human Resources

- ⇒ Re-engineer Human Resources

The Future is Now

Competition for customers is inevitable in the electric utility industry. This approved budget represents the initial movement toward making Austin Electric Utility more competitive. We are striving to make significant changes in a short time frame and with an open, honest process that allows input from citizens, regulatory entities, and our employees. Our mission is to provide quality products and services at competitive prices in the markets we serve.



Milton Lee
General Manager
Austin Electric Utility