



# City Public Service of San Antonio, Texas

Basic Financial Statements  
For the Fiscal Years Ended January 31, 2018 and 2017

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

### INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") serves as an introduction to the financial statements of City Public Service Board of San Antonio (also referred to as "CPS Energy" or the "Company"). It is intended to be an objective and easily understandable analysis of significant financial and operating activities and events for the fiscal year ("FY") ended January 31, 2018, ("FY 2018") compared to the fiscal year ended January 31, 2017 ("FY 2017"). It also provides an overview of CPS Energy's general financial condition and results of operations for FY 2017, compared to the previous fiscal year ended January 31, 2016 ("FY 2016"). This MD&A has been prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and should be read in conjunction with the audited financial statements and accompanying notes that follow.

### BASIC FINANCIAL STATEMENTS OVERVIEW

In accordance with GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, the Statements of Net Position present CPS Energy's assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position as of the end of each fiscal year.

Assets are separated into current and noncurrent categories and are reported in the order of liquidity. Current assets include unrestricted cash and cash equivalents; investments; customer, interest and other accounts receivable; and inventories, as well as prepayments and other current assets. Noncurrent assets include cash and cash equivalents, investments, and interest and other accounts receivable that have been restricted by state laws, ordinances or contracts. Noncurrent assets also include the pension regulatory asset, other noncurrent assets and net capital assets.

Deferred outflows of resources include unrealized pension and other postemployment benefits ("OPEB") contributions made in the current year, unrealized losses related to pension and OPEB, unrealized losses on fuel hedges and unamortized debt reacquisition costs.

Consistent with the reporting of assets on the Statements of Net Position, liabilities are segregated into current and noncurrent categories. Current liabilities include the current maturities of debt, accounts payable and accrued liabilities. Noncurrent liabilities include net long-term debt, decommissioning liability, decommissioning net costs refundable, net pension liability and other noncurrent liabilities.

Deferred inflows of resources include unrealized gains related to fuel hedges, unrealized gains related to pension and unrealized revenues associated with the FY 2014 sale of certain assets.

The Statements of Net Position report net position as the difference between (a) the sum of assets and deferred outflows of resources and (b) the sum of liabilities and deferred inflows of resources. The components of net position are classified as net investment in capital assets, restricted or unrestricted. An unrestricted designation indicates the net funds are available for operations.

Within the Statements of Revenues, Expenses and Changes in Net Position, operating results are reported separately from nonoperating results, which primarily relate to financing and investing. Other payments to the City of San Antonio, contributed capital, and the effect of the South Texas Project's ("STP") defined-benefit plan funding obligations are also reported separately as components of the change in net position. These statements identify revenue generated from sales to cover operating and nonoperating expenses. Operating expenses are presented by major cost categories. Revenues remaining are available to service debt, fulfill city payment commitments, finance capital expenditures and cover contingencies.

The Statements of Cash Flows present cash flows from operating activities, capital and related financing activities, noncapital financing activities, and investing activities. These statements are prepared using the direct method, which reports gross cash receipts and payments, and presents a reconciliation of operating income to net cash provided by operating activities. These statements also separately list the noncash financing activities.

## FINANCIAL HIGHLIGHTS AND SIGNIFICANT ACCOUNTING POLICIES

**Allowance for Funds Used During Construction ("AFUDC")** – To reflect funding methodology, the AFUDC rate includes both a debt and an equity component. The blended rate is composed of 50% equity and 50% debt based on construction funding. The rate is reviewed quarterly to determine if any adjustments are necessary. Alternate AFUDC rates are applied to projects costing more than \$100 million, reflecting the method by which they are funded.

**Battery Energy Storage Systems ("BESS")** – On September 20, 2016, CPS Energy accepted a \$3.0 million New Technology Implementation Grant from the Texas Commission on Environmental Quality ("TCEQ"). The grant proceeds will subsidize the purchase of a lithium-ion 5MW, 2-hour battery to be installed near the Southwest Research Institute substation and adjacent to solar generation resources. The battery will allow generation produced during peak solar intervals to be made available later during peak demand intervals and has an expected commercial operation date of early FY 2020. As of January 31, 2018, CPS Energy has incurred approximately \$0.7 million on the project. Limits on TCEQ funding require that costs reimbursable under the grant be incurred and paid by May 31, 2019.

**Build America Bonds ("BABs")** – The American Recovery and Reinvestment Act ("ARRA") of 2009 provided authority for the issuance of BABs, which were issuable in calendar years 2009 and 2010 as taxable bonds. The ARRA permitted the issuer or the issuer's paying agent to receive subsidy payments equal to 35% of the bond's interest costs directly from the U.S. Department of the Treasury. Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, the federal government reduced the BABs subsidy by 7.3% for payments made during the period October 1, 2014, through September 30, 2015. The subsidy was reduced by 6.8% from October 1, 2015, through September 30, 2016. The subsidy was reduced by 6.9% from October 1, 2016, through September 30, 2017. The subsidy is being reduced by 6.6% from October 1, 2017, through September 30, 2018. Transaction details for CPS Energy's BABs issuances are provided in Note 6 – Revenue Bonds.

**The City of San Antonio** – CPS Energy is considered an asset of the community through its legal ownership by the City of San Antonio, Texas ("City"). In turn, CPS Energy is treated as a component unit of the City, which has a September 30 fiscal year end.

**Contributed Capital** – Third-party contributions made for construction of capital assets flow through the Statements of Revenues, Expenses and Changes in Net Position and are shown on the Statements of Net Position as a component of net investment in capital assets. The amount reported for contributed capital was \$43.9 million for FY 2018, as compared with \$59.5 million for FY 2017. This included donated assets of \$2.6 million and \$5.9 million, respectively. The remaining portion of these balances, \$41.3 million for

See accompanying independent auditors' report.

FY 2018, and \$53.6 million for FY 2017, represents contributions received from customers as payments for utility extensions and services, as well as funding for the Light Emitting Diode (“LED”) streetlight project and a project to develop an independent spent fuel storage installation (“Dry Cask Storage Project”).

**Counterparty Risk** – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, fuel hedging and wholesale power. Counterparty risk is the risk that a counterparty will fail to meet its obligations in accordance with the terms and conditions of its contract with the Company. The Company has policies and practices in place to ensure the solvency of counterparties is assessed accurately, monitored regularly and managed actively through its Enterprise Risk Management & Solutions Division.

**CPS Energy Component Units** – As required under GASB Statement No. 61, *The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34*, the assets and liabilities accumulated for CPS Energy’s two decommissioning trusts for STP Units 1 and 2 (“Decommissioning Trusts” or “Trusts”) are combined into the CPS Energy financial statements using the blended method of inclusion. Initially, CPS Energy owned a 28% interest in STP Units 1 and 2. In May 2005, CPS Energy purchased an additional 12% interest in these units. Assets from an associated decommissioning trust were also received with this purchase. CPS Energy reports the assets in both Trusts—the 28% interest and the 12% interest—as component units.

**Decommissioning** – The Company accounts for decommissioning by recognizing a liability and expense for a pro rata share of projected decommissioning costs as determined by the most recent cost study. A new cost study is performed every five years; in years subsequent to the latest study, estimated annual decommissioning expense and an increase in the liability is calculated by applying the effects of inflation and the ratio of years of plant usage to total plant life. The total decommissioning liability and related annual decommissioning expense is calculated assuming the longer total plant life due to the license extensions approved in FY 2018. See Note 14 – South Texas Project for additional details on the most recent cost study and license extensions.

Additionally, due to requirements under the Code of Federal Regulations governing nuclear decommissioning trust funds, a zero net position approach is applied in accounting for the Decommissioning Trusts. Accordingly, current year and prior year activity in the Trusts is reported in the nonoperating income (expense) section of the Statements of Revenues, Expenses and Changes in Net Position as Decommissioning net costs recoverable (refundable). The cumulative effect of activity in the Trusts is reported on the Statements of Net Position as a noncurrent liability referred to as decommissioning net costs refundable since any excess funds are payable to customers. Going forward, prolonged unfavorable economic conditions could result in the assets of the Trusts being less than the estimated decommissioning liability. In that case, instead of an excess as currently exists, there would be a deficit that would be reported as decommissioning net costs recoverable. This amount would be receivable from customers.

Currently, the Dry Cask Storage Project is under way at STP in order to provide for storage of spent nuclear fuel after the spent fuel pool has reached capacity. CPS Energy’s Decommissioning Trusts have separate spent fuel management accounts to pay for those costs. By contract, spent fuel will eventually be removed to final storage by the Department of Energy (“DOE”). The DOE failed to meet the contractual start date to receive spent fuel, and STP and other utilities have reached settlement agreements with the DOE. In the most recent settlement agreement dated March 15, 2017, the DOE extended its commitment to reimburse STP for allowable spent fuel management expenditures through 2019.

Ongoing costs for the spent fuel management project are being funded by the STP owners (CPS Energy; the City of Austin; and NRG South Texas LP, a wholly owned subsidiary of NRG Energy, Inc.) as expenditures are incurred. CPS Energy is entitled to request reimbursement at its discretion from its Decommissioning Trusts for the Company's portion of allowable costs. Annually, the South Texas Project Nuclear Operating Company ("STPNOC") submits claims to the DOE for the reimbursement of allowable costs for spent fuel management. Allowable costs are returned to the owners by STPNOC upon receipt of funds from the DOE. In turn, the settlement amount received from the DOE by CPS Energy is reimbursable to the Trusts. Qualifying spent fuel management costs not reimbursable by the DOE are funded by the Trusts. Spent fuel management costs that do not qualify for reimbursement by the DOE or the Trusts are recorded as operation and maintenance ("O&M") expense or capital costs.

**Depreciation Study** – In FY 2018, CPS Energy engaged an independent third-party consulting firm to conduct a depreciation study, which is performed every five years. The new depreciation rates that resulted from the study were retroactively applied to the beginning of FY 2018. As a result of the study, based on the plant in service as of January 31, 2017, total annual depreciation decreased by approximately 3% based on the updated estimated useful lives.

**ERCOT Nodal Market System** – Electric Reliability Council of Texas ("ERCOT") is the independent system operator managing the flow of electric power for approximately 90% of the electric load for the state of Texas. ERCOT schedules power on the electric grid in a nodal market with more than 4,000 pricing nodes. In the nodal market system, generators are required to make their capacity and ancillary services available to ERCOT, and load-serving entities purchase their supply needs from ERCOT in the day-ahead market and true up in the real-time market. As both a generator and load-serving entity, CPS Energy is an active participant in the nodal market system and actively monitors and manages its exposure to the risks inherent in the retail and wholesale markets.

**Federal Grant Programs** – Periodically, federal grants are made available to CPS Energy as a subrecipient for a portion of grant funds allocated to the state of Texas. Grant receipts are recorded as nonoperating income and generally reimburse CPS Energy for costs, recorded as operating expenses, incurred in the administration of the program. This accounting treatment results in no impact to the Company's net position. Revenues associated with the grant-related programs are exempt from payments of a percentage of gross revenues made to the City. Grant funding received by the Company is subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

**Flexible Rate Revolving Note ("FRRN") Private Placement Program** – On January 20, 2009, CPS Energy's Board of Trustees ("Board") authorized the establishment of a flexible rate revolving note program to provide additional liquidity in support of the Company's electric and gas systems ("Systems"). Under the current program, CPS Energy can issue taxable or tax-exempt notes with individual maturities of one year or less at fixed or variable interest rates in an aggregate principal amount at any one time outstanding not to exceed \$26 million, reduced in FY 2016 from \$100 million. The program became effective on April 28, 2009, and through annual renewals authorizes the issuance of such notes through November 1, 2028. The FRRN has been classified as short-term in accordance with the financing terms of the Note Purchase Agreement and is reported on the Statements of Net Position under current maturities of debt. The note outstanding under this program totaled \$25.2 million at January 31, 2018 and 2017. See Note 8 – Flexible Rate Revolving Note.

**Hedging Derivative Instruments** – CPS Energy accounts for derivative instruments in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Currently, CPS Energy's only derivative instruments are fuel hedges, which are used to reduce price risk for natural gas

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purchases. GASB Statement No. 53 requires that hedging derivative instruments be reported at fair value on the Statements of Net Position. In FY 2018, 35% of distribution and 16% of generation natural gas volumes were hedged. In FY 2017, 49% of distribution and 16% of generation natural gas volumes were hedged. See Note 12 – Other Financial Instruments.

**Generation Asset Purchase** – In FY 2013, taxable senior lien bonds were issued to purchase the Rio Nogales combined-cycle natural gas electric generating plant in Seguin, Texas. The 800-MW plant was being utilized to provide a portion of its power to a third party that had executed a multiyear agreement, which expired in September 2015, for an option to call on power from the plant. Any remaining power was available for CPS Energy to sell into the ERCOT market or to utilize to meet its commitments. As of February 1, 2016, CPS Energy integrated the Rio Nogales plant into its rate base to provide generation capacity that will not otherwise be available once J.T. Deely Units 1 and 2 are mothballed in FY 2019. In conjunction with the purchase, CPS Energy entered into a Tax Exemption Settlement Agreement in which CPS Energy agreed to pay \$25.5 million to certain parties to compromise, terminate claims and settle any disputes relating to exemption of ad valorem taxes involving the parties to this agreement. The payment was recorded as an intangible asset that is being amortized over the life of the agreement, which runs through December 2041. See Note 4 – Capital Assets, Net for more details on the Rio Nogales plant purchase.

**Pension Plan** – The financial statements of the CPS Energy Pension Plan (“Plan”) are separately audited and reported. The financial results of the Plan are not included herein except for certain disclosures as provided in Note 9 – Employee Pension Plan and in Required Supplementary Information. In 2012, GASB issued a standard addressing accounting and financial reporting for all government-sponsored pension plans administered as trusts. CPS Energy adopted the new guidance in FY 2015 and concurrently restated its prior fiscal year financial statements to reflect the effects of the guidance for all periods presented. The requirements of the guidance include significant changes in the measurement and recognition of the Company’s liability related to the Plan, recognition of deferred outflows of resources and deferred inflows of resources related to pension, changes in the measurement of pension expense, as well as comprehensive changes to the disclosures included in the notes to the financial statements and in Required Supplementary Information. The net effect of prior period restatements made to comply with the guidance was accounted for as a regulatory asset that is being amortized over a 50-year period. Regulatory accounting, in accordance with guidance provided by GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, permits certain costs to be capitalized as regulatory assets until they are recovered through future rates.

**Postemployment Benefits Other Than Pension (“OPEB”)** – The CPS Energy Group Health, Group Life Insurance and Long-Term Disability Income Plans (collectively, “Employee Benefit Plans”) are separately audited and reported. The financial results of the Employee Benefit Plans are not included herein except for certain disclosures as provided in Note 10 – Other Postemployment Benefits and in Required Supplementary Information. In 2015, GASB issued a standard addressing accounting and financial reporting for all government-sponsored OPEB plans administered as trusts. CPS Energy adopted the new guidance in FY 2018 and concurrently restated its prior fiscal year financial statements to reflect the effects of the guidance for all periods presented. The requirements of the guidance include significant changes in the measurement and recognition of the Company’s liability related to the Employee Benefit Plans, recognition of deferred outflows of resources and deferred inflows of resources related to OPEB, changes in the measurement of OPEB expense, as well as comprehensive changes to the disclosures included in the notes to the financial statements and in Required Supplementary Information.

**Rate Increases** – Rates are set by the Board and approved by the San Antonio City Council. On November 7, 2013, the City Council approved a 4.25% increase in both CPS Energy’s electric and natural gas base rates, which were effective February 2014.

**Reclassifications** – Certain amounts in the prior years’ financial statements have been reclassified to conform to the current-year presentation.

**SA Energy Acquisition Public Facility Corporation (“PFC”)** – The PFC is a public, nonprofit corporation organized under the laws of the state of Texas pursuant to the Texas Public Facility Corporation Act, Chapter 303, Texas Local Government Code. The PFC was organized in FY 2008 to assist its sponsor, the City, in the procurement of natural gas and in financing, refinancing or providing public facilities to be devoted to public use. The PFC is a component unit of the City.

On June 14, 2007, the PFC entered into a Natural Gas Supply Agreement with the City, acting by and through CPS Energy. This gas supply agreement provides for the sale to CPS Energy, on a pay-as-you-go basis, of all natural gas to be delivered to the PFC under a Prepaid Natural Gas Sales Agreement. Under this prepaid gas agreement between the PFC and J. Aron, the gas supplier and a subsidiary of Goldman, Sachs & Co., the PFC prepaid the cost of a specified supply of natural gas to be delivered over 20 years. CPS Energy’s net savings resulting from this transaction are passed on, in their entirety, to its distribution gas customers. The financial statements of the PFC are separately audited and reported.

On February 25, 2013, the PFC executed certain amendments to the Prepaid Natural Gas Sales Agreement entered into with J. Aron in 2007 and other related documents with respect to the 2007 prepayment transaction with J. Aron. Under the resolution and the amendments, Goldman, Sachs & Co. surrendered for cancellation \$111.1 million of the SA Energy Acquisition Public Facility Corporation Gas Supply Revenue Bonds, Series 2007 owned by J. Aron; Goldman, Sachs & Co.; or affiliates. In exchange, the PFC agreed to reduce future required natural gas delivery volumes from 104.6 million MMBtu to 81.3 million MMBtu and to adjust the notional amount of its commodities price hedge so that hedged revenue from gas sales will bear at least the same proportion to annual debt service requirements as before the transaction. In conjunction with the transaction, a portion of the savings related to the purchase of natural gas from the PFC that would have been passed on to CPS Energy’s distribution gas customers over the 20-year life of the original agreement was accelerated. Distribution gas customers benefitted from the accelerated savings from March 1, 2013, through June 30, 2015.

On June 30, 2016, as a result of a Novation Agreement by and among The Bank of New York Mellon Trust Company, N. A. (formerly known as The Bank of New York Trust Company, N. A.), as trustee (“Trustee”), the PFC, Depfa Bank plc (“Transferor”) and J. Aron & Company (“Transferee”), the Transferee assumed all of the Transferor’s rights, title and interest in and to the Investment Agreement and all the duties, obligations and liabilities under the Investment Agreement (excluding any rights, obligations or liabilities of the Trustee or the Transferor prior to the Novation Effective Date). In addition, an Amended and Restated Investment Agreement was entered into to amend and restate the terms of the Investment Agreement. Consequently, a Second Supplemental Indenture to the Trust Indenture, by and between the PFC and the Trustee, was executed. The original Investment Agreement dated June 21, 2007, was replaced by the Amended and Restated Investment Agreement.

**Save for Tomorrow Energy Plan (“STEP”)** – CPS Energy is authorized, per City ordinance, to spend up to \$849 million over a 13-year period, which began in FY 2009, on energy efficiency and conservation through STEP. Contributing towards its goal to save 771 MW by 2020, CPS Energy’s programs include home weatherization, higher efficiency light bulbs, solar rebates, peak saver thermostats, home area networks, demand response, rooftop and community solar programs, and other such initiatives.

See accompanying independent auditors’ report.

Annually, approximately \$9.0 million of STEP expenses are funded through the electric base rate and reported as O&M expenses. STEP expenses in excess of this initial amount per year are recovered through the fuel adjustment factor over a period of 12 months, or longer for certain STEP expenses, beginning in the subsequent fiscal year after the costs are incurred and have been independently validated. These STEP recoveries are accrued as a regulatory asset referred to as STEP net costs recoverable.

**Solar Prepayments** – In November 2011, the Company entered into a prepaid agreement with SunEdison for purchased power from San Antonio-area solar energy facilities with a total of 30 MW of capacity. In 2012, SunEdison sold the facilities to San Antonio Solar Holdings LLC; however, SunEdison retained ownership of the land for one of the sites and continued as operator under an agreement with San Antonio Solar Holdings LLC. In FY 2013, \$77.0 million in prepayments were made for approximately 60% of the anticipated annual output over a period of 25 years. In April 2016, SunEdison filed for Chapter 11 bankruptcy protection; however, CPS Energy had no remaining agreements directly with SunEdison and determined that the event had no impact on CPS Energy’s prepaid transaction. At January 31, 2018, of the remaining prepayment balance, \$3.1 million was classified as current and \$56.8 million was classified as noncurrent. At January 31, 2017, of the remaining prepayment balance, \$3.1 million was classified as current and \$59.9 million was classified as noncurrent. The purchase of the balance of the output is on a pay-as-you-go basis. As part of the agreement, CPS Energy has the right to purchase the facilities six years after commencement of commercial operation. During 2012, operations began for each of the three facilities that underlie the agreement. CPS Energy is currently considering its right to purchase the facilities, but no decision has been made.

**STP Units 1 and 2** – Correlating to CPS Energy’s 40% interest in STP Units 1 and 2 that have been in operation since 1988 and 1989, respectively, the applicable financial results of the nonprofit special-purpose operations project are combined within these financial statements. These units were originally licensed by the Nuclear Regulatory Commission (“NRC”) to operate for a period of 40 years, expiring in 2027 and 2028, respectively. An application to extend the license for an additional 20 years was approved by the NRC in September 2017. STP follows Financial Accounting Standards Board guidance. See Note 14 – South Texas Project.

**STP Units 3 and 4** – On October 29, 2007, the Board approved a resolution enabling CPS Energy to participate in development activities related to new nuclear generation units to be constructed near Bay City, Texas, on a site where STP Units 1 and 2 currently operate. The development project is referred to as STP Units 3 and 4. At January 31, 2010, CPS Energy held a 50% interest in the development. As a result of a litigation settlement with Nuclear Innovation North America, Inc., the Company’s partner in the project, CPS Energy’s ownership in STP Units 3 and 4 was reduced from 50% to 7.625% effective March 1, 2010. In FY 2016, the Company reached the conclusion that as a result of sustained changes in a number of environmental and economic factors directly affecting the projected economic feasibility of completing construction of STP Units 3 and 4, the project had experienced a permanent impairment. The Company determined it was appropriate to write off the entire \$391.4 million investment in STP Units 3 and 4. The impairment loss was recorded as an extraordinary item on CPS Energy’s Statements of Revenues, Expenses, and Changes in Net Position for FY 2016. For more detailed information on STP Units 3 and 4, see Note 14 – South Texas Project.

## RESULTS OF OPERATIONS

**Summary of Revenues, Expenses and Changes in Net Position**  
(Dollars in thousands)

	Fiscal Year Ended January 31,			Change			
	2018	2017 Restated	2016 Restated	2018 vs. 2017		2017 vs. 2016	
Revenues and nonoperating income							
Electric	\$ 2,439,858	\$ 2,299,504	\$ 2,320,005	\$ 140,354	6.1%	\$ (20,501)	-0.9%
Gas	180,411	165,814	175,300	14,597	8.8%	(9,486)	-5.4%
Total operating revenues	2,620,269	2,465,318	2,495,305	154,951	6.3%	(29,987)	-1.2%
Nonoperating income, net	47,052	38,754	36,041	8,298	21.4%	2,713	7.5%
Total revenues and nonoperating income	2,667,321	2,504,072	2,531,346	163,249	6.5%	(27,274)	-1.1%
Expenses							
Operating expenses							
Fuel, purchased power and distribution gas	832,070	751,646	789,134	80,424	10.7%	(37,488)	-4.8%
Operation and maintenance	539,797	514,824	521,775	24,973	4.9%	(6,951)	-1.3%
Annual OPEB expense	(10,396)	10,789	3,664	(21,185)	-196.4%	7,125	194.5%
Pension expense	51,576	75,259	42,717	(23,683)	-31.5%	32,542	76.2%
Energy efficiency and conservation (STEP)	80,731	102,211	62,884	(21,480)	-21.0%	39,327	62.5%
STEP net costs recoverable	7,813	(39,818)	(6,509)	47,631	119.6%	(33,309)	-511.7%
Regulatory assessments	84,083	74,965	66,965	9,118	12.2%	8,000	11.9%
Decommissioning	29,639	26,741	17,714	2,898	10.8%	9,027	51.0%
Depreciation and amortization	425,260	426,760	410,228	(1,500)	-0.4%	16,532	4.0%
Total operating expenses	2,040,573	1,943,377	1,908,572	97,196	5.0%	34,805	1.8%
Nonoperating expenses							
Interest and debt-related	199,785	196,962	199,945	2,823	1.4%	(2,983)	-1.5%
Payments to the City of San Antonio	338,455	324,469	320,454	13,986	4.3%	4,015	1.3%
Total nonoperating expenses	538,240	521,431	520,399	16,809	3.2%	1,032	0.2%
Total expenses	2,578,813	2,464,808	2,428,971	114,005	4.6%	35,837	1.5%
Income before other changes in net position	88,508	39,264	102,375	49,244	125.4%	(63,111)	-61.6%
Other payments to the City of San Antonio	(11,720)	(11,613)	(11,601)	(107)	-0.9%	(12)	-0.1%
Contributed capital	43,868	59,459	46,497	(15,591)	-26.2%	12,962	27.9%
Extraordinary item- impairment loss	-	-	(391,417)	-	-	391,417	100.0%
Effect of defined benefit plan funding obligations - STP	(10,610)	(9,320)	2,267	(1,290)	-13.8%	(11,587)	-511.1%
Change in net position	110,046	77,790	(251,879)	32,256	41.5%	329,669	130.9%
Net position - beginning	3,388,243	3,310,453	3,562,332	77,790	2.3%	(251,879)	-7.1%
Net position - ending	\$ 3,498,289	\$ 3,388,243	\$ 3,310,453	\$ 110,046	3.2%	\$ 77,790	2.3%

### Total Revenues and Nonoperating Income

**FY 2018** – Representing 98.2% of total revenues and nonoperating income, electric and gas revenues of \$2,620.3 million increased by \$155.0 million, or 6.3%, compared to FY 2017.

To meet its combined sales requirements for retail customers within the greater San Antonio certificated area and wholesale customers outside of this area, electric energy is primarily generated by CPS Energy from three sources—coal, nuclear and gas. Approximately 83.3% and 82.7% of its customers' electric energy needs in FY 2018 and FY 2017, respectively, were produced from CPS Energy's generating units. In addition to the energy produced from Company-owned facilities, CPS Energy also purchased power from third parties, including producers of renewable energy, such as solar-generated and wind-generated power.

Representing 91.5% of CPS Energy's total revenues and nonoperating income, electric operating revenue of \$2,439.9 million increased \$140.4 million from FY 2017. Contributing to the increase were higher retail and wholesale fuel recoveries primarily resulting from the higher unit cost of fuel and increased sales volume, as well as higher STEP recoveries.

See accompanying independent auditors' report.

Representing 6.7% of total revenues and nonoperating income, gas revenue totaled \$180.4 million, a \$14.6 million increase from FY 2017. This increase was due to higher fuel recoveries resulting from the higher unit cost of fuel and increased sales volume.

Net nonoperating income of \$47.1 million increased \$8.3 million from FY 2017, primarily due to improved market conditions which led to higher investment income in the Decommissioning Trusts.

***FY 2017*** – Representing 98.5% of total revenues and nonoperating income, electric and gas revenues of \$2,465.3 million decreased by \$30.0 million, or 1.2%, compared to FY 2016.

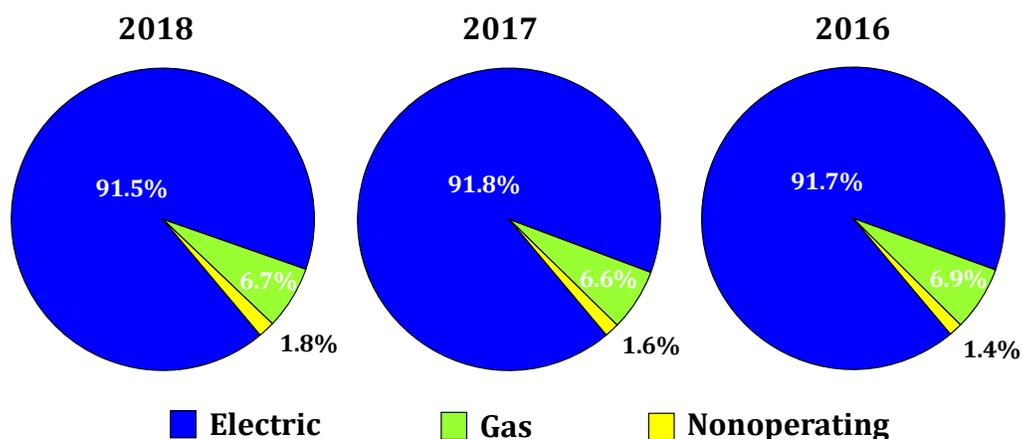
Approximately 82.7% and 76.2% of its customers’ electric energy needs in FY 2017 and FY 2016, respectively, were produced from CPS Energy’s generating units.

Representing 91.8% of CPS Energy’s total revenues and nonoperating income, electric operating revenue of \$2,299.5 million decreased \$20.5 million from FY 2016. Contributing to the decrease were lower wholesale revenues due to lower wholesale volumes, partially offset by higher retail revenues due to higher nonfuel recoveries resulting from higher retail volumes and higher regulatory recoveries.

Representing 6.6% of total revenues and nonoperating income, gas revenue totaled \$165.8 million, a \$9.5 million decrease from FY 2016. This decrease was due to lower nonfuel recoveries as a result of lower volumes during milder winter months, partially offset by a higher average unit cost of fuel.

Net nonoperating income of \$38.8 million increased \$2.7 million from FY 2016, primarily due to higher investment income related to the Decommissioning Trusts due to more favorable market performance on equities in FY 2017.

**Total Revenues and Nonoperating Income  
Fiscal Year Ended January 31,**



**Operating Expenses**

***FY 2018*** – Operating expenses of \$2,040.6 million were \$97.2 million, or 5.0%, above last year’s total of \$1,943.4 million.

Combined electric and gas fuel costs, which are passed through to customers, totaled \$832.1 million and comprised 40.8% of total operating expenses. Electric fuel and purchased power costs of \$749.1 million increased \$70.2 million, or 10.3%, above last year primarily due to higher unit cost of fuel and higher volumes. Distribution gas costs of \$83.0 million increased by \$10.2 million, or 14.1%, from last year due to higher sales volume and higher unit cost.

Operation and maintenance expenses (including annual OPEB and pension expense and STP O&M) of \$581.0 million were \$19.9 million, or 3.3%, lower than last year due to lower OPEB expense resulting from the favorable impact of GASB 75 implementation and lower pension expense resulting from the favorable benefit trust investment performance, partially offset by higher labor costs.

STEP expense of \$80.7 million was \$21.5 million less than last year's expense of \$102.2 million, primarily due to lower solar rebate amounts compared to the rebate program in the prior year. The related contra expense account, STEP net costs recoverable, reflects the net change during the period in expenses delayed to future periods when they will be recognized concurrent with their recovery through rate adjustments. This contra expense was \$7.8 million compared to \$(39.8) million last year. This operating statement item reflects the transfer of these costs to/from the balance sheet as they are deferred or amortized.

Regulatory assessments, including those charged by the PUCT and ERCOT, of \$84.1 million were \$9.1 million higher due to increased transmission costs of service ("TCOS") expenses.

STP decommissioning expense of \$29.6 million was \$2.9 million higher than last year's expense of \$26.7 million primarily due to an increase in the inflation rate used to calculate the annual change in the estimated liability.

Depreciation and amortization expense of \$425.3 million was comparable to last year's expense of \$426.8 million.

***FY 2017*** – Operating expenses of \$1,943.3 million were \$34.8 million, or 1.8%, above the FY 2016 total of \$1,908.6 million.

Combined electric and gas fuel costs, which are passed through to customers, totaled \$751.6 million and comprised 38.7% of total operating expenses. Electric fuel and purchased power costs of \$678.9 million decreased \$34.7 million, 4.9%, below FY 2016 primarily due to lower wholesale sales volumes as well as average unit cost. Distribution gas costs of \$72.7 million decreased by \$2.8 million, or 3.7%, from FY 2016 due to lower sales volumes from mild winter weather.

Operation and maintenance expenses (including annual OPEB and pension expense and STP O&M) of \$600.9 million were \$32.7 million, or 5.8%, higher than FY 2016 due to higher pension expense and outside services costs, partially offset by lower STP O&M costs as a result of one scheduled refueling outage in calendar year 2016 compared to two in 2015.

STEP expense was \$102.2 million and was higher than FY 2016 expense due to planned progressive spending on this program. These amounts represent costs incurred in the current year above the approximately \$9.0 million funded through the base rate and recorded as O&M expenses. The related contra expense account, STEP net costs recoverable, reflects the net change during the period in expenses delayed to future periods when they will be recognized concurrent with their recovery through rate adjustments. This contra expense was \$(39.8) million compared to \$(6.5) million for FY 2016.

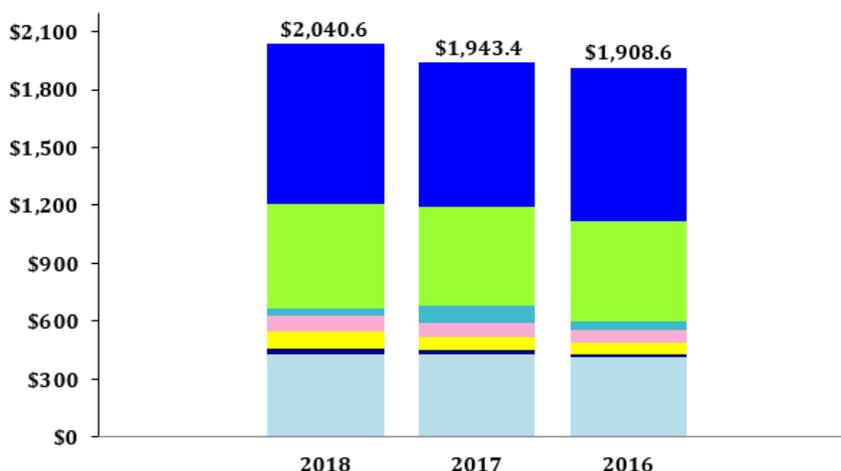
See accompanying independent auditors' report.

Regulatory assessments, including those charged by the PUCT and ERCOT, of \$75.0 million were \$8.0 million higher than FY 2016 due to increased TCOS expenses.

Decommissioning expense of \$26.7 million was \$9.0 million, or 51.0%, higher than the FY 2016 expense of \$17.7 million primarily due to an increase in the inflation rate used to estimate the annual expense accrual.

Depreciation and amortization expense of \$426.8 million was higher by \$16.5 million, or 4.0%, compared to FY 2016 due to the normal increase of plant-in-service.

**Total Operating Expenses**  
Fiscal Year Ended January 31,  
(In millions)



<span style="color: blue;">■</span> Fuel, purchased power and distribution gas	<b>\$832.1</b>	\$ 751.6	\$ 789.1
<span style="color: green;">■</span> Operation and maintenance	<b>539.8</b>	514.8	521.8
<span style="color: cyan;">■</span> Annual OPEB and pension expense	<b>41.2</b>	86.1	46.4
<span style="color: pink;">■</span> Regulatory assessments	<b>84.1</b>	75.0	67.0
<span style="color: yellow;">■</span> Energy efficiency and conservation (STEP) and STEP net costs recoverable	<b>88.5</b>	62.4	56.4
<span style="color: darkblue;">■</span> Decommissioning	<b>29.6</b>	26.7	17.7
<span style="color: lightblue;">■</span> Depreciation and amortization	<b>425.3</b>	426.8	410.2

**Nonoperating Income (Expenses)**

***FY 2018*** – Interest expense and other debt-related costs, including amortization of debt expense and AFUDC, totaled \$199.8 million and were \$2.8 million, or 1.4%, higher than last year. The increase was due to higher interest expense related to bond issuances.

The payment to the City totaled \$338.5 million and was \$14.0 million higher than the same period last year due to higher revenues.

***FY 2017*** – Interest expense and other debt-related costs, including amortization of debt expense and AFUDC, totaled \$197.0 million and were \$3.0 million, or 1.5%, lower than FY 2016. The decrease was due

to increased amortization of debt premiums related to 2016 refunding bond issuances as well as higher assets under construction ("AUC"), partially offset by increased interest expense.

The recorded payments to the City, totaled \$324.5 million and were \$4.0 million higher than FY 2016 due to higher electric retail revenues.

### **Other Changes in Net Position**

**FY 2018** – Net income of \$88.5 million was \$49.2 million higher than last year's net income of \$39.3 million, an increase of 125.4%, primarily due to higher nonfuel revenues and lower OPEB and pension expense, partially offset by higher O&M expenses.

Other payments to the City, based on 1% of prior year gross revenues, totaled \$11.7 million in FY 2018 and were comparable to last year.

Contributed capital of \$43.9 million was \$15.6 million lower than last year. Primarily contributing to the decrease were fewer reimbursed projects completed in the current year.

The effect of the STP defined benefit plan funding obligations, which represents 40% of the change in the unfunded pension and other post-retirement benefits liability at STP, was \$(10.6) million compared to \$(9.3) million last year. The \$(1.3) million net change is primarily due to the remeasurement of the STP defined benefit plan obligations.

CPS Energy's change in net position was an increase of \$110.0 million compared to an increase of \$77.8 million last year, a favorable change of \$32.2 million, due to the net income drivers explained previously.

**FY 2017** – Net income of \$39.3 million was \$63.1 million lower than the net income for FY 2016 of \$102.4 million. Primarily contributing to the variance were lower wholesale nonfuel revenues and higher pension and outside services costs, partially offset by lower O&M costs.

Other payments to the City totaled \$11.6 million in FY 2017 and FY 2016.

Contributed capital of \$59.5 million was \$13.0 million higher than FY 2016. Primarily contributing to the increase was a greater number of reimbursed projects completed in FY 2017.

There were no extraordinary items in FY 2017. In FY 2016, the Company recorded a loss of \$391.4 million related to the noncash impairment of CPS Energy's investment in STP Units 3 and 4.

The effect of the STP defined benefit plan funding obligations, which represents 40% of the change in the unfunded pension and other post-retirement benefits liability at STP, was \$(9.3) million compared to \$2.3 million in FY 2016, reflecting a net change of \$(11.6) million primarily due to the remeasurement of the STP defined benefit plan obligations.

CPS Energy's change in net position was \$77.8 million compared to \$(251.9) million in FY 2016. Primarily contributing to the favorable change of \$329.7 million were the factors mentioned above affecting net income and the STP Units 3 and 4 impairment loss recorded in the FY 2016 results.

See accompanying independent auditors' report.

## FINANCIAL POSITION

### Statements of Net Position Summary

(Dollars in thousands)

	January 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
<b>Assets</b>		Restated	Restated				
Current assets	\$ 935,802	\$ 877,359	\$ 865,169	\$ 58,443	6.7%	\$ 12,190	1.4%
Noncurrent assets							
Restricted	1,289,952	1,160,578	1,501,870	129,374	11.1%	(341,292)	-22.7%
Other noncurrent assets	529,328	475,571	448,825	53,757	11.3%	26,746	6.0%
Capital assets, net	8,190,356	8,053,304	7,777,505	137,052	1.7%	275,799	3.5%
Total assets	10,945,438	10,566,812	10,593,369	378,626	3.6%	(26,557)	-0.3%
Deferred outflows of resources	182,853	346,961	210,710	(164,108)	-47.3%	136,251	64.7%
Total assets plus deferred outflows of resources	\$ 11,128,291	\$ 10,913,773	\$ 10,804,079	\$ 214,518	2.0%	\$ 109,694	1.0%
<b>Liabilities</b>							
Current liabilities	\$ 620,671	\$ 588,283	\$ 583,701	\$ 32,388	5.5%	\$ 4,582	0.8%
Long-term debt, net	5,833,768	5,716,313	5,870,328	117,455	2.1%	(154,015)	-2.6%
Other noncurrent liabilities	1,118,967	1,173,389	960,084	(54,422)	-4.6%	213,305	22.2%
Total liabilities	7,573,406	7,477,985	7,414,113	95,421	1.3%	63,872	0.9%
Deferred inflows of resources	56,596	47,545	79,513	9,051	19.0%	(31,968)	-40.2%
Total liabilities plus deferred inflows of resources	7,630,002	7,525,530	7,493,626	104,472	1.4%	31,904	0.4%
<b>Net position</b>							
Net investment in capital assets	2,162,433	2,156,211	1,722,692	6,222	0.3%	433,519	25.2%
Restricted	699,036	613,430	974,402	85,606	14.0%	(360,972)	-37.0%
Unrestricted	636,820	618,602	613,359	18,218	2.9%	5,243	0.9%
Total net position	3,498,289	3,388,243	3,310,453	110,046	3.2%	77,790	2.3%
Total liabilities plus deferred inflows of resources plus net position	\$ 11,128,291	\$ 10,913,773	\$ 10,804,079	\$ 214,518	2.0%	\$ 109,694	1.0%

### Current Assets

***FY 2018*** – Current assets at January 31, 2018, of \$935.8 million were \$58.4 million higher than the balance at January 31, 2017, due to increases of \$52.1 million in customer accounts receivable, \$19.2 million in the General Fund, \$2.4 million in current interest and other accounts receivable and \$1.1 million in solar farm deposits. These increases were partially offset by decreases of \$5.5 million in coal inventory, \$4.6 million in current prepayments, \$2.9 million in materials and supplies, \$1.9 million in customer deposits and \$1.3 million in insurance reserves.

***FY 2017*** – Current assets at January 31, 2017, of \$877.4 million were \$12.2 million higher than the balance at January 31, 2016, due to increases of \$14.0 million in current interest and other accounts receivable, \$8.0 million in the General Fund, \$3.6 million in insurance reserves, and \$2.7 million in customer deposits. These increases were partially offset by decreases of \$4.2 million in customer accounts receivable and \$11.5 million in current prepayments.

### Noncurrent Restricted Assets

***FY 2018*** – Noncurrent restricted assets totaled \$1,290.0 million at January 31, 2018, an increase of \$129.4 million compared to January 31, 2017. The overall variance was largely attributable to increases of \$102.9 million in the Repair and Replacement Account and \$42.8 million in the Decommissioning Trust balances. These increases were partially offset by a \$15.8 million decrease in the Capital Projects Fund.

**FY 2017** – Noncurrent restricted assets totaled \$1,160.6 million at January 31, 2017, a decrease of \$341.3 million compared to January 31, 2016. The overall variance was largely attributable to decreases of \$327.8 million in the Capital Projects Fund due to new construction funding and \$29.4 million in the Repair and Replacement Account. These decreases were partially offset by an increase of \$14.1 million in the Decommissioning Trusts balances.

### **Other Noncurrent Assets**

**FY 2018** – Other noncurrent assets increased to \$529.3 million at January 31, 2018, from \$475.6 million at January 31, 2017. The \$53.8 million change reflects increases of \$46.0 million in the net OPEB asset resulting from adoption of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, \$33.5 million in long-term service agreement inventory due to a new agreement for the Rio Nogales plant and \$1.6 million in noncurrent prepayments. These increases were partially offset by decreases of \$21.5 million in STEP net costs recoverable due to reclassification of approved FY 2017 costs to short-term accounts receivable and \$5.3 million in the pension regulatory asset.

**FY 2017** – Other noncurrent assets increased to \$475.6 million at January 31, 2017, from \$448.8 million at January 31, 2016. The \$26.8 million change reflects increases of \$39.3 million in STEP net costs recoverable, \$18.7 million in long-term service agreement inventory and \$1.0 million in unamortized bond expense. These increases were partially offset by decreases of \$27.8 million in the net OPEB asset resulting from adoption of GASB Statement No. 75 and \$5.3 million in the pension regulatory asset.

### **Deferred Outflows of Resources**

**FY 2018** – Deferred outflows of resources decreased \$164.1 million, from \$347.0 million at January 31, 2017, to \$182.9 million at January 31, 2018, primarily due to decreases of \$149.0 million in deferred outflows related to pension and OPEB to reflect an updated actuarial valuation and adoption of GASB Statement No. 75, \$14.1 million in unamortized reacquisition costs and \$1.0 million in unrealized losses on fuel hedges.

**FY 2017** – Deferred outflows of resources increased \$136.3 million, from \$210.7 million at January 31, 2016, to \$347.0 million at January 31, 2017, primarily due to increases of \$137.1 million in deferred outflows related to pension and OPEB, and \$29.2 million in unamortized reacquisition costs, partially offset by a decrease of \$30.1 million in unrealized losses on fuel hedges. The increase in deferred outflows related to pension and OPEB was primarily due to changes in actuarial valuations to reflect actual market performance and to adoption of GASB Statement No. 75. Also contributing was an increase in unamortized reacquisition costs due to the new series 2016 revenue refunding bond issuance in July 2016.

**Capital Assets, Net**

**Summary of Capital Assets**  
**Net of Accumulated Depreciation and Amortization**  
(Dollars in thousands)

	January 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
<b>Nondepreciable assets</b>							
Land	\$ 97,125	\$ 87,889	\$ 71,164	\$ 9,236	10.5%	\$ 16,725	23.5%
Land easements	106,217	89,258	88,699	16,959	19.0%	559	0.6%
Construction-in-progress	521,471	622,296	484,239	(100,825)	-16.2%	138,057	28.5%
Total nondepreciable assets	<u>724,813</u>	<u>799,443</u>	<u>644,102</u>	<u>(74,630)</u>	-9.3%	<u>155,341</u>	24.1%
<b>Depreciable/amortizable assets</b>							
<b>Electric plant</b>							
Buildings and structures	536,021	556,758	586,649	(20,737)	-3.7%	(29,891)	-5.1%
Systems and improvements	5,543,289	5,416,585	5,334,072	126,704	2.3%	82,513	1.5%
Total electric plant	<u>6,079,310</u>	<u>5,973,343</u>	<u>5,920,721</u>	<u>105,967</u>	1.8%	<u>52,622</u>	0.9%
<b>Gas plant</b>							
Buildings and structures	89	91	94	(2)	-2.2%	(3)	-3.2%
Systems and improvements	595,411	556,471	521,088	38,940	7.0%	35,383	6.8%
Total gas plant	<u>595,500</u>	<u>556,562</u>	<u>521,182</u>	<u>38,938</u>	7.0%	<u>35,380</u>	6.8%
<b>General plant</b>							
Buildings and structures	182,309	171,567	170,060	10,742	6.3%	1,507	0.9%
Machinery and equipment	293,331	289,536	282,022	3,795	1.3%	7,514	2.7%
Other	5,336	3,884	4,068	1,452	37.4%	(184)	-4.5%
Total general plant	<u>480,976</u>	<u>464,987</u>	<u>456,150</u>	<u>15,989</u>	3.4%	<u>8,837</u>	1.9%
<b>Intangibles</b>							
Software	155,657	104,923	104,553	50,734	48.4%	370	0.4%
Other	32,197	23,373	24,386	8,824	37.8%	(1,013)	-4.2%
Total intangibles	<u>187,854</u>	<u>128,296</u>	<u>128,939</u>	<u>59,558</u>	46.4%	<u>(643)</u>	-0.5%
Nuclear fuel	<u>121,903</u>	<u>130,673</u>	<u>106,411</u>	<u>(8,770)</u>	-6.7%	<u>24,262</u>	22.8%
Total depreciable/ amortizable assets	<u>7,465,543</u>	<u>7,253,861</u>	<u>7,133,403</u>	<u>211,682</u>	2.9%	<u>120,458</u>	1.7%
Total capital assets, net	<u>\$8,190,356</u>	<u>\$8,053,304</u>	<u>\$7,777,505</u>	<u>\$ 137,052</u>	1.7%	<u>\$ 275,799</u>	3.5%

***FY 2018*** – At January 31, 2018, net capital assets of \$8,190.4 million increased \$137.1 million from \$8,053.3 million at January 31, 2017. The increase was primarily due to a \$126.7 million increase in the electric plant systems and improvements component of total depreciable assets. Total depreciable/amortizable assets increased \$211.7 million.

Of the total plant-in-service and construction-in-progress additions, \$571.0 million is related to new construction and net removal costs. These additions included funding with \$350.8 million of debt, \$41.3 million from contributed capital and \$178.9 million from the Repair and Replacement Account. Included in capital assets is CPS Energy's 40% interest in STP Units 1 and 2.

***FY 2017*** – At January 31, 2017, net capital assets of \$8,053.3 million increased \$275.8 million from \$7,777.5 million at January 31, 2016. The increase was primarily due to a \$138.1 million increase in the construction-in-progress component of total nondepreciable assets. Total depreciable/amortizable assets increased \$120.5 million.

Of the total plant-in-service and construction-in-progress additions, \$673.3 million is related to new construction and net removal costs. These additions included funding with \$328.1 million of debt, \$53.6 million from contributed capital and \$291.6 million from the Repair and Replacement Account. Included in capital assets is CPS Energy's 40% interest in STP Units 1 and 2.

In June 2016, the Board approved the purchase of an existing building and land in downtown San Antonio which will become CPS Energy's new corporate headquarters. The two towers on the property are being redeveloped and the site is expected to be ready for employees in 2020. The building is recorded as construction-in-progress until renovations are complete.

### **Current Liabilities**

**FY 2018** – Excluding current maturities of debt of \$195.1 million, current liabilities increased \$19.3 million, from \$406.3 million at January 31, 2017, to \$425.6 million at January 31, 2018. The higher balance was primarily due to increases of \$15.4 million in accounts payable and accrued liabilities, \$3.4 million in payable to the City, \$2.2 million in STP operating, maintenance and construction payables and \$2.0 million in current customer advances for construction, partially offset by decreases of \$1.1 million in the Decommissioning Trust liability and \$1.0 million in current customer deposits.

**FY 2017** – Excluding current maturities of debt of \$182.0 million, current liabilities increased \$7.8 million, from \$398.5 million at January 31, 2016, to \$ 406.3 million at January 31, 2017. The higher balance was primarily due to increases of \$23.7 million in STP operating, maintenance and construction payables due to a uranium purchase in January 2017, \$1.7 million in customer deposits, \$1.1 million in pollution remediation, \$1.1 million in the Decommissioning Trust liability, and \$1.1 million in payable to the City. These increases were partially offset by decreases of \$18.2 million in accounts payable and accrued liabilities and \$2.7 million in current customer advances for construction.

### **Other Noncurrent Liabilities**

**FY 2018** – Excluding the noncurrent portion of debt of \$5,833.8 million, noncurrent liabilities decreased \$54.4 million to \$1,119.0 million at January 31, 2018, primarily due to a \$121.9 million decrease in net pension liability to reflect an updated actuarial valuation, partially offset by increases of \$25.2 million in decommissioning liability, \$18.7 million in decommissioning net costs refundable, \$18.2 million in long-term service liability due to a new agreement for the Rio Nogales plant, \$4.7 million in other liabilities and \$2.6 million in STP OPEB and pension liability.

**FY 2017** – Excluding the noncurrent portion of debt of \$5,716.3 million, noncurrent liabilities increased \$213.3 million to \$1,173.4 million at January 31, 2017, primarily due to increases of \$168.1 million in net pension liability, \$33.1 million in long-term service agreement liability, \$22.0 million in decommissioning liability, \$6.1 million in the STP OPEB and pension liability, \$3.9 million in operating reserves and \$1.0 million in noncurrent customer deposits. These increases were partially offset by decreases of \$18.3 million in other liabilities and \$3.5 million in decommissioning net costs refundable.

### **Deferred Inflows of Resources**

**FY 2018** – Deferred inflows of resources increased \$9.1 million, from \$47.5 million at January 31, 2017, to \$56.6 million at January 31, 2018, primarily due to increases of \$7.2 million in deferred inflows related to pension and \$2.8 million in unrealized gains on fuel hedges, partially offset by a \$1.0 million decrease in deferred tower license income.

See accompanying independent auditors' report.

**FY 2017** – Deferred inflows of resources decreased \$32.0 million, from \$79.5 million at January 31, 2016, to \$47.5 million at January 31, 2017, primarily due to a decrease of \$31.7 million in deferred inflows related to pension.

## FINANCING AND DEBT COVENANTS COMPLIANCE

### Long-Term Debt (Excluding Commercial Paper)

**FY 2018** – At January 31, 2018, CPS Energy’s total debt was \$5,485.0 million, excluding commercial paper, the FRRN, discounts and premiums. This long-term debt was composed of \$4,894.9 million in fixed-interest-rate instruments and \$590.1 million in variable-interest-rate instruments. Fixed-interest-rate long-term debt had an overall weighted-average yield of 4.2%. Separately, the variable-rate bonds had a weighted-average yield of 2.4%.

*Issuances* – On April 27, 2017, CPS Energy issued \$308.0 million of New Series 2017 Senior Lien Revenue and Refunding Bonds. Bond proceeds, including the \$36.7 million premium associated with the bonds, are primarily being used to fund construction projects and were partially used to refund \$32.8 million and \$17.3 million par value of the New Series 2006B Revenue Refunding Bonds and New Series 2007 Revenue and Refunding Bonds, respectively. The refunding transaction resulted in a net present value debt service savings of \$1.8 million, or 3.6% of the par amount of the bonds being refunded. The true interest cost for this issue, which has maturities in 2018 through 2047, is 3.77%.

On August 30, 2017, CPS Energy issued \$195.0 million of New Series 2017 Senior Lien Revenue Refunding Bonds. Proceeds, including the \$36.5 million premium associated with the bonds, were used to refund \$150.0 million and \$80.0 million par value of the Commercial Paper Series A and Commercial Paper Series C, respectively. The true interest cost for this issue, which has maturities in 2026 through 2047, is 3.62%.

On September 14, 2017, CPS Energy remarketed \$123.3 million of Series 2015B Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$2.3 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$1.7 million. The bonds have maturities in 2029 through 2033. The coupon rate for these bonds is 2.0%, with a current yield of 1.48% and true interest cost of 4.92%, which reflects stepped interest rate provisions applicable to the bonds.

*Reductions* – CPS Energy made principal payments of \$149.2 million in FY 2018. Additional principal paydowns related to refunding and remarketing transactions during the year totaled \$175.1 million.

### Summary of Debt Rollforward Activity<sup>1</sup>

(In thousands)

Balance Outstanding <u>February 1, 2017</u>	Additions <u>During Year</u>	Decreases <u>During Year</u>	Balance Outstanding <u>January 31, 2018</u>
<u>\$ 5,182,985</u>	<u>\$ 626,260</u>	<u>\$ (324,270)</u>	<u>\$ 5,484,975</u>

<sup>1</sup>Excludes commercial paper, the FRRN, discounts and premiums.

**FY 2017** – At January 31, 2017, CPS Energy’s total debt was \$5,183.0 million, excluding commercial paper, the FRRN, discounts and premiums. This long-term debt was composed of \$4,591.2 million in

fixed-interest-rate instruments and \$591.8 million in variable-interest-rate instruments. Fixed-interest-rate long-term debt had an overall weighted-average yield of 4.1%. Separately, the variable-rate bonds had a weighted-average yield of 2.2%.

*Issuances* – On July 28, 2016, CPS Energy issued \$544.3 million of New Series 2016 Senior Lien Revenue Refunding Bonds. Proceeds, including the \$122.7 million premium associated with the bonds, were used to refund \$243.5 million and \$365.6 million par value of the New Series 2008 Revenue Bonds and New Series 2009A Revenue Refunding Bonds, respectively. The refunding transaction resulted in a net present value debt service savings of \$109.2 million, or 17.9% of the par value of the bonds being refunded. The true interest cost for this issue, which has maturities in 2020 through 2034, is 2.14%.

On December 1, 2016, CPS Energy remarketed \$47.5 million of Series 2012C Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$0.5 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$0.2 million. The bonds have maturities in 2024 through 2027. The coupon rate for these bonds is 2.0%, with a current yield of 1.50% and true interest cost of 6.40%, which reflects a stepped interest of 8.0% that is only applicable if the bonds are not remarketed before their expiration date.

On December 14, 2016, CPS Energy remarketed \$124.6 million of Series 2015A Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$1.1 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$0.4 million. The bonds have maturities in 2029 through 2033. The coupon rate for these bonds is 2.25%, with a current yield of 1.95% and true interest cost of 6.29%, which reflects a stepped interest of 8.0% that is only applicable if the bonds are not remarketed before their expiration date.

*Reductions* – CPS Energy made principal payments of \$160.0 million in FY 2017. Additional principal paydowns related to refunding and remarketing transactions during the year totaled \$781.7 million.

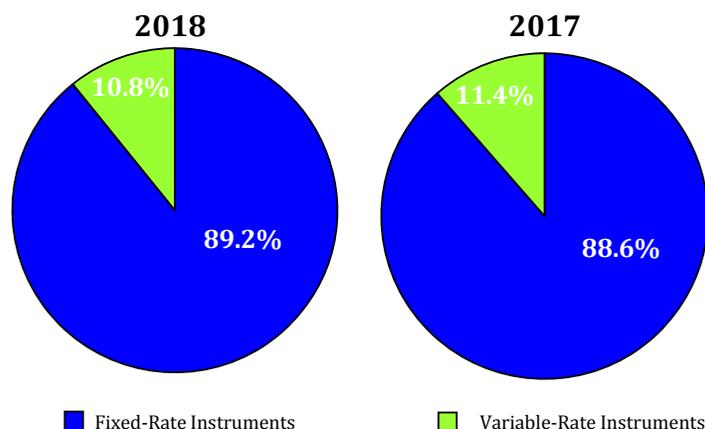
**Summary of Debt Rollforward Activity<sup>1</sup>**  
(In thousands)

Balance Outstanding February 1, 2016	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2017
\$ 5,408,365	\$ 716,315	\$ (941,695)	\$ 5,182,985

<sup>1</sup>Excludes commercial paper, the FRRN, discounts and premiums.

See accompanying independent auditors' report.

**Allocation of Debt  
at January 31,**



**Note: Graphs exclude commercial paper and the FRRN.**

**Commercial Paper**

CPS Energy maintains a commercial paper program to provide taxable and tax-exempt financing for various purposes. In 1988, the San Antonio City Council adopted an ordinance authorizing the issuance of up to \$300 million in tax-exempt commercial paper. The current ordinances allow for the issuance of three separate series of commercial paper to provide funding to assist in the interim financing of eligible projects in an aggregate amount not to exceed \$600 million to the extent of support from liquidity facilities. As of January 31, 2018, there was a total of \$600 million in liquidity support. The ordinances allow for the issuance of taxable commercial paper, as well as tax-exempt commercial paper. Eligible projects include fuel acquisition, capital improvements to the Systems, and refinancing or refunding any outstanding obligations, which are secured by and payable from a lien and/or a pledge of net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of existing New Series Bonds (senior lien obligations) and Series Bonds (junior lien obligations). Scheduled maximum maturities cannot extend beyond November 1, 2042.

The commercial paper has been classified as long-term in accordance with the refinancing terms under three revolving credit agreements with a consortium of banks, which support the commercial paper program. The Series A agreement, which provides \$150 million in liquidity support for the Series A Notes, is effective through February 6, 2019. The Series B agreement, which provides \$225 million in liquidity support for the Series B Notes, is effective through June 21, 2019. The Series C agreement, which provides \$225 million in liquidity support for the Series C Notes, is effective through June 21, 2019. Under the terms of these revolving credit agreements, CPS Energy may borrow up to an aggregate amount not to exceed \$600 million for the purpose of paying principal due under the commercial paper program. At January 31, 2018, there was no amount outstanding under the revolving credit agreements. Further, there have been no borrowings under the agreements since inception of the program.

***FY 2018 – Issuances*** – CPS Energy issued a total of \$30.0 million in commercial paper in FY 2018 to fund construction costs.

***Reductions*** – CPS Energy made reductions in the outstanding amount totaling \$230.0 million related to the commercial paper refunding transaction in FY 2018.

At January 31, 2018, the outstanding commercial paper balance was \$160.0 million, all of which was issued as tax-exempt.

### Summary of Commercial Paper Rollforward Activity

(In thousands)

Balance Outstanding February 1, 2017	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2018
\$ 360,000	\$ 30,000	\$ (230,000)	\$ 160,000

**FY 2017** – There were no commercial paper issuances or reductions during FY 2017. At January 31, 2017, the outstanding commercial paper balance was \$360.0 million, all of which was issued as tax-exempt.

### Summary of Commercial Paper Rollforward Activity

(In thousands)

Balance Outstanding February 1, 2016	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2017
\$ 360,000	\$ -	\$ -	\$ 360,000

The weighted-average interest rate on outstanding commercial paper was 1.2% at January 31, 2018, and 0.8% at January 31, 2017. The weighted-average maturity of commercial paper at January 31, 2018 and 2017, was 60 and 55 days, respectively.

### Flexible Rate Revolving Note

CPS Energy maintains a FRRN private placement program to provide taxable and tax-exempt financing to assist in the interim funding of eligible projects in an aggregate amount not to exceed the currently effective limit of \$26 million. The FRRN has been classified as short-term in accordance with the financing terms under the Note Purchase Agreements. See Note 8 – Flexible Rate Revolving Note.

**FY 2018** – There were no note issuances or reductions under the FRRN program during FY 2018. At January 31, 2018, the outstanding FRRN balance was \$25.2 million.

**FY 2017** – There were no note issuances or reductions under the FRRN program during FY 2017. At January 31, 2017, the outstanding FRRN balance was \$25.2 million.

### Compliance

With respect to all New Series Bonds outstanding at January 31, 2018, the net revenues of the Systems are pledged to the payment of principal and interest thereon. All New Series Bonds are issued as senior lien obligations, and the principal and interest thereon have a first lien upon the net revenues of CPS Energy's Systems.

The Series 2010A and 2010B Junior Lien BABs; the Series 2012A, 2012B and 2012C Variable-Rate Junior Lien Revenue Refunding Bonds; the Series 2013 and Series 2014 Junior Lien Revenue Bonds; the Series 2015A and 2015B Variable-Rate Junior Lien Revenue Refunding Bonds; and the Series 2015C and 2015D Variable-Rate Junior Lien Revenue Bonds were issued as junior lien obligations. The borrowings from the junior lien obligations are equally and ratably secured by and payable from the net revenues of

See accompanying independent auditors' report.

CPS Energy's Systems. The pledge is subordinate and inferior to the pledge of net revenues securing the senior lien obligations, but prior and superior to the lien on, and pledge of, the net revenues securing the payment of the commercial paper notes.

The commercial paper revolving credit agreements permit CPS Energy to borrow up to an aggregate amount, not to exceed \$600 million, for the purpose of paying amounts due under the commercial paper program. The commercial paper outstanding is also secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of senior lien and junior lien obligations.

Under the terms of the current FRRN purchase agreement, the credit facility is taxable to the full extent of the current \$26 million limit on outstanding principal. The outstanding notes are secured by collateral pledged in the form of investments and a limited, subordinate and inferior lien on and pledge of net revenues in the amount of \$0.1 million.

At January 31, 2018 and 2017, CPS Energy was in compliance with the terms and provisions of the documents related to the senior and junior lien obligations, and the commercial paper and FRRN programs.

### **Debt Service**

CPS Energy has taken the position that the BABs direct subsidy should be deducted from debt service when calculating the debt service coverage ratio since the subsidy is received directly by the trustee and is to be used solely for debt service. Therefore, at January 31, 2018, the debt service coverage calculations included a BABs direct subsidy deduction of \$14.6 million for the senior lien debt and \$24.4 million for both the senior and junior lien debt. At January 31, 2017, the debt service coverage calculations included a BABs direct subsidy deduction of \$14.5 million for the senior lien debt and \$24.3 million for both the senior and junior lien debt.

*BABs Subsidy Sequestration* – Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, the federal government reduced the BABs subsidy by 7.3% for payments made during the period October 1, 2014, through September 30, 2015. The subsidy was reduced by 6.8% from October 1, 2015, through September 30, 2016. The subsidy was reduced by 6.9% from October 1, 2016, through September 30, 2017. The subsidy is being reduced by 6.6% from October 1, 2017, through September 30, 2018. The subsidy reductions resulted in an increase in CPS Energy's debt-related interest expense of approximately \$1.8 million in FY 2018.

The following table illustrates the debt service coverage ratios in accordance with the bond ordinances and also provides the ratios without the direct subsidy deduction:

**Debt Service Coverage Ratios  
at January 31, 2018**

	With <u>BABs Subsidy</u>	Without <u>BABs Subsidy</u>
Senior lien debt	3.84x	3.64x
Senior and junior lien debt	2.65x	2.49x

**Debt Service Coverage Ratios  
at January 31, 2017**

	With <u>BABs Subsidy</u>	Without <u>BABs Subsidy</u>
Senior lien debt	3.46x	3.30x
Senior and junior lien debt	2.58x	2.43x

The ratio of debt to debt and net position was 61.8% at January 31, 2018, and 62.2% at January 31, 2017.

**Summary of CPS Energy's Bond and Commercial Paper Ratings**

	<u>Ratings at January 31, 2018</u>		
	<u>Senior Lien Debt</u>	<u>Junior Lien Debt</u>	<u>Commercial Paper</u>
Fitch Ratings	AA+	AA+	F1+
Moody's Investors Service, Inc.	Aa1	Aa2	P-1
S&P Global Ratings	AA	AA-	A-1+

**CURRENTLY KNOWN FACTS**

**GASB Implementations** – The following guidance issued by the GASB will be effective for future periods:

- GASB Statement No. 83, *Certain Asset Retirement Obligations*, establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for legally enforceable asset retirement obligations and requires that recognition occur when the liability is both incurred and reasonably estimable. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2019. The Company has initiated an evaluation of the impact that adoption of this Statement will have on its financial statements.
- GASB Statement No. 84, *Fiduciary Activities*, establishes criteria for identifying fiduciary activities of all state and local governments for accounting and financial reporting purposes and how those activities should be reported. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2020. The Company has not yet determined the effect this Statement will have on its financial statements.

See accompanying independent auditors' report.

- GASB Statement No. 87, *Leases*, requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. The standard establishes a single model for lease accounting based on the foundational principle that leases are financings of the right-to-use an underlying asset. Under the Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, which enhances the relevance and consistency of information about the Company's leasing activities. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2021. The Company has not yet determined the effect this Statement will have on its financial statements.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, requires additional essential information related to debt disclosure in the notes to the financial statements. Required disclosures include unused lines of credit, assets pledged as collateral for the debt, and terms specified in debt agreements which are related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. Under the Statement, direct borrowings and direct placement of debt is required to be reported separately from other debt. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2019. The Company has not yet determined the effect this Statement will have on CPS Energy's financial statements.

**Legislation and Regulations** – The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") was signed into law on July 21, 2010. Title VII of the Dodd-Frank Act, known as the "Wall Street Transparency and Accountability Act of 2010," substantially modified portions of the Commodity Exchange Act with respect to swap transactions. The law was designed to reduce risk, establish new business conduct rules, increase transparency and promote market integrity within the financial system. The Dodd-Frank Act gave the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") statutory authority to regulate the over-the-counter derivatives market, including many of the commodities that are currently being traded or hedged by CPS Energy in accordance with its own policies and procedures. CPS Energy is subject to some of the CFTC and SEC rules, including swap transaction reporting and recordkeeping, in addition to other administrative rules and regulations, such as the Independent Registered Municipal Advisor rule that impacts capital market participants. As an "end-user" CPS Energy is currently exempt from clearing and margining its over-the-counter positions and from capital requirements related to its commodities activities.

The modification of CPS Energy's contract arrangements with hedging counterparties, bringing in various representations, elections and commitments as to reporting obligations and other matters, has been necessary due to regulatory requirements. Further modifications of this type are anticipated, contingent on rules to be promulgated or implemented. New relationship documentation would also take these into account. The CFTC and SEC, as well as U.S. prudential regulators charged with guarding against systemic risk to the banking and financial system, remain in the process of proposing, finalizing and implementing rules pursuant to the legislation. Consequently, the overall impact on CPS Energy remains uncertain at this time.

While there continues to be uncertainty regarding the future of the Patient Protection and Affordable Care Act, CPS Energy remains focused on its long-term strategy to address any potential cost increases associated with the health plan benefits it provides to its employees. The Company continues to monitor health care regulations as they evolve, as well as the status of the CPS Energy employee health plans, to

ensure compliance with all regulations, while maintaining manageable plan costs for the Company and its employees.

Several pending federal environmental regulations could affect CPS Energy, including the Environmental Protection Agency's ("EPA") proposed rule to rescind the Clean Power Plan ("CPP"), rule proposals to replace the CPP and proposal for the Waters of the U.S. rule. The Generation Sector Industrial Effluent Guidelines rule's effective date has been delayed for two years until November 2020 during which time the EPA intends to propose and finalize a new rule for power plant wastewater discharge limits.

In late 2017, the EPA made attainment designations for the 2015 ozone standard under the National Ambient Air Quality Standards, except for Bexar County. The EPA is allowing the State of Texas to submit additional data for review and is scheduled to make a final designation for Bexar County and the region in August 2018.

The EPA is working to revise the Coal Combustion Residual ("CCR") rule to increase flexibility in setting permit requirements through state CCR permit programs and is planning a second CCR rulemaking to address other issues. CPS Energy is in compliance with all current regulatory requirements and continues to monitor, evaluate, and assess the impacts of new and pending regulations on CPS Energy's strategies and operations.

**Federal Budget Developments** – In December 2017, Congress passed the Tax Cuts & Jobs Act ("Act"). The Act preserved tax-exempt financing for municipal bonds but eliminated the use of advanced refundings at the end of calendar year 2017. The Act also reduced the corporate tax rate from 35% to 21% effective in 2018. This 14 percentage point reduction represents a 40% drop, which could potentially make tax-exempt municipal bonds less attractive to some investors.

In March 2018, Congress approved an omnibus budget bill that will fund all federal agencies for the balance of the federal government's fiscal year 2018. In regard to the status of BABs, the White House Office of Management and Budget recently recommended that payments to issuers of BABs be cut by 6.2% from October 1, 2018, through September 30, 2019. This issue remains a focal point of conversation within Congress and the situation remains fluid.

As Congressional lawmakers continue to look for ways to manage the federal budget, future proposals affecting financing tools, such as the tax exemption on municipal bond interest and BABs, could be revisited. CPS Energy's management continues to assess proposals to offer commentary and information to the national discussion. Uncertainty remains regarding the impact any resulting legislation might ultimately have on the tax-exempt status of CPS Energy's bonds.

## **REQUESTS FOR INFORMATION**

For more information about CPS Energy, contact Corporate Communications, Marketing & Smart City Outreach at (210) 353-2344 or at P.O. Box 1771, San Antonio, Texas 78296-1771.

## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees  
City Public Service of San Antonio, Texas  
San Antonio, Texas

We have audited the accompanying financial statements of City Public Service of San Antonio, Texas ("CPS Energy"), a component unit of the City of San Antonio, Texas as of and for the years ended January 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise CPS Energy's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to CPS Energy's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CPS Energy's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CPS Energy as of January 31, 2018 and 2017, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphasis of Matter**

As discussed in Note 1, CPS Energy adopted the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective February 1, 2017. Our opinion is not modified with respect to this matter.

## **Other Matter**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the required supplementary information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Marga, Preis + Co., LLC Baker Tilly Virchow Krause, LLP Robert Williams CPA*

San Antonio, Texas  
Austin, Texas  
April 30, 2018

**STATEMENTS OF NET POSITION**

	January 31,	
	<u>2018</u>	<u>2017</u>
		Restated
	(In thousands)	
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 205,418	\$ 191,492
Investments	163,486	160,241
Interest and other accounts receivable	47,065	44,648
Customer accounts receivable, less allowance for doubtful accounts of \$16.1 million at January 31, 2018, and \$15.7 million at January 31, 2017	272,252	220,105
Inventories, at average costs		
Materials and supplies, net	99,983	102,864
Fossil fuels	102,602	107,573
Prepayments and other	44,996	50,436
Total current assets	<u>935,802</u>	<u>877,359</u>
<b>Noncurrent assets</b>		
Restricted		
Cash and cash equivalents	166,669	114,440
Investments	1,116,139	1,033,398
Interest and other accounts receivable	7,144	12,740
Pension regulatory asset	245,135	250,464
Other noncurrent assets	284,193	225,107
Capital assets, net	8,190,356	8,053,304
Total noncurrent assets	<u>10,009,636</u>	<u>9,689,453</u>
Total assets	<u>10,945,438</u>	<u>10,566,812</u>
<b>Deferred outflows of resources</b>		
Unrealized contributions and losses related to pension and OPEB	95,267	244,316
Unrealized losses on fuel hedges	6,866	7,819
Unamortized debt reacquisition costs	80,720	94,826
Total deferred outflows of resources	<u>182,853</u>	<u>346,961</u>
Total assets plus deferred outflows of resources	<u>\$ 11,128,291</u>	<u>\$ 10,913,773</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Current maturities of debt	\$ 195,095	\$ 182,010
Accounts payable and accrued liabilities	425,576	406,273
Total current liabilities	<u>620,671</u>	<u>588,283</u>
<b>Noncurrent liabilities</b>		
Long-term debt, net	5,833,768	5,716,313
Decommissioning	463,098	437,902
Decommissioning net costs refundable	125,968	107,317
Net pension liability	312,462	434,411
Other noncurrent liabilities	217,439	193,759
Total noncurrent liabilities	<u>6,952,735</u>	<u>6,889,702</u>
Total liabilities	<u>7,573,406</u>	<u>7,477,985</u>
<b>Deferred inflows of resources</b>		
Unrealized gains on fuel hedges	2,824	-
Unrealized gains related to pension	50,512	43,282
Sale of future revenue	3,260	4,263
Total deferred inflows of resources	<u>56,596</u>	<u>47,545</u>
Total liabilities plus deferred inflows of resources	<u>7,630,002</u>	<u>7,525,530</u>
<b>Net position</b>		
Net investment in capital assets	2,162,433	2,156,211
Restricted		
Debt service	12,971	14,476
Ordinance	686,065	598,954
Unrestricted	636,820	618,602
Total net position	<u>3,498,289</u>	<u>3,388,243</u>
Total liabilities plus deferred inflows of resources plus net position	<u>\$ 11,128,291</u>	<u>\$ 10,913,773</u>

See accompanying Notes to Basic Financial Statements.

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Fiscal Year Ended January 31,	
	<u>2018</u>	<u>2017</u> Restated
	(In thousands)	
Operating revenues		
Electric		
Retail	\$ 2,240,968	\$ 2,132,647
Wholesale	<u>198,890</u>	<u>166,857</u>
Total electric operating revenues	2,439,858	2,299,504
Gas	<u>180,411</u>	<u>165,814</u>
Total operating revenues	<u>2,620,269</u>	<u>2,465,318</u>
Operating expenses		
Fuel, purchased power and distribution gas	832,070	751,646
Operation and maintenance	539,797	514,824
Annual OPEB and pension expense	41,180	86,048
Energy efficiency and conservation (STEP)	80,731	102,211
STEP net costs recoverable	7,813	(39,818)
Regulatory assessments	84,083	74,965
Decommissioning	29,639	26,741
Depreciation and amortization	<u>425,260</u>	<u>426,760</u>
Total operating expenses	<u>2,040,573</u>	<u>1,943,377</u>
Operating income	<u>579,696</u>	<u>521,941</u>
Nonoperating income (expense)		
Interest and other income, net	17,413	12,912
Decommissioning Trusts investment income and change in fair market value	48,290	22,378
Decommissioning net costs recoverable (refundable)	(18,651)	3,464
Interest and other expense	(242,027)	(236,089)
Amortization of debt-related costs	29,626	27,449
Allowance for funds used during construction	12,616	11,678
Payments to the City of San Antonio	<u>(338,455)</u>	<u>(324,469)</u>
Total nonoperating income (expense)	<u>(491,188)</u>	<u>(482,677)</u>
Income before other changes in net position	88,508	39,264
Other payments to the City of San Antonio	(11,720)	(11,613)
Contributed capital	43,868	59,459
Effect of defined benefit plan funding obligations – STP	<u>(10,610)</u>	<u>(9,320)</u>
Change in net position	110,046	77,790
Net position – beginning	3,388,243	3,310,453
Net position – ending	<u>\$ 3,498,289</u>	<u>\$ 3,388,243</u>

See accompanying Notes to Basic Financial Statements.

## STATEMENTS OF CASH FLOWS

	Fiscal Year Ended January 31,	
	2018	2017
		Restated
	(In thousands)	
Cash flows from operating activities		
Cash received from customers	\$ 2,564,968	\$ 2,456,268
Cash payments to suppliers for goods and services	(1,300,829)	(1,223,270)
Cash payments to employees for service	(208,977)	(193,197)
Net cash provided (used) by operating activities	<u>1,055,162</u>	<u>1,039,801</u>
Cash flows from capital and related financing activities		
Cash paid for additions to utility plant and net removal costs	(597,247)	(723,420)
Contributed capital	41,309	53,516
Proceeds from issuance of revenue bonds	334,076	4,163
Principal payments on revenue bonds and cash defeasance of debt	(156,575)	(160,000)
Interest paid	(242,031)	(235,189)
Debt issue and cash defeasance costs paid	(4,005)	(4,140)
Net cash provided (used) by capital and related financing activities	<u>(624,473)</u>	<u>(1,065,070)</u>
Cash flows from noncapital financing activities		
Cash payments to the City of San Antonio	(346,639)	(334,959)
Cash flows from investing activities		
Purchases of investments	(542,993)	(1,036,584)
Proceeds from sales and maturities of investments	485,147	1,195,926
Interest and other income	39,951	42,756
Net cash provided (used) by investing activities	<u>(17,895)</u>	<u>202,098</u>
Net increase (decrease) in cash and cash equivalents	66,155	(158,130)
Cash and cash equivalents at beginning of period	305,932	464,062
Cash and cash equivalents at end of period	<u>\$ 372,087</u>	<u>\$ 305,932</u>
<u>Reconciliation of operating income to net cash provided by operating activities</u>		
Cash flows from operating activities		
Operating income	\$ 579,696	\$ 521,941
Noncash items included		
Depreciation and amortization	425,260	426,760
Nuclear fuel amortization	46,173	45,145
Provision for doubtful accounts	9,544	8,129
Changes in current assets and liabilities		
(Increase) decrease in customer accounts receivable, net	(61,691)	(3,910)
(Increase) decrease in other receivables	(2,305)	(14,301)
(Increase) decrease in materials and supplies	2,881	(1,122)
(Increase) decrease in fossil fuels	4,971	1,173
(Increase) decrease in prepayments and other	5,440	11,816
Increase (decrease) in accounts payable and accrued liabilities	26,519	13,895
Changes in noncurrent and other assets and liabilities		
(Increase) decrease in other noncurrent assets and prepaid costs	(56,557)	(29,354)
Increase (decrease) in customer service deposits payable	(848)	1,032
Increase (decrease) in decommissioning liability	25,196	21,663
Increase (decrease) in noncurrent liabilities	(105,396)	205,510
Changes in deferred outflows of resources	149,049	(136,852)
Changes in deferred inflows of resources	7,230	(31,724)
Net cash provided (used) by operating activities	<u>\$ 1,055,162</u>	<u>\$ 1,039,801</u>
<u>Noncash financing activities</u>		
Bond proceeds deposited into an escrow account for purposes of refunding long-term debt	\$ 406,044	\$ 663,760
Donated assets received and recorded	\$ 2,559	\$ 5,943

## NOTES TO BASIC FINANCIAL STATEMENTS

### January 31, 2018 and 2017

#### 1. Summary of Significant Accounting Policies

**Reporting Entity** – City Public Service Board of San Antonio (also referred to as “CPS Energy” or the “Company”) has been owned by the City of San Antonio, Texas (“City”) since 1942. CPS Energy provides electricity and natural gas to San Antonio and surrounding areas. As a municipally owned utility, CPS Energy is exempt from the payment of income taxes, state franchise taxes, use taxes, and real and personal property taxes. CPS Energy provides certain payments and benefits to the City as permitted by bond ordinances. CPS Energy’s financial results are also included within the comprehensive annual financial report of the City.

The decision to include applicable component units in CPS Energy’s financial statements was made by applying the criteria set forth in Governmental Accounting Standards Board (“GASB”) Statement No. 61, *The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34*. The following legally separate entities, for which CPS Energy is financially accountable and with which a financial benefit/burden relationship exists, meet those criteria for inclusion in CPS Energy’s financial statements as component units; therefore, their financial statements are blended with those of CPS Energy:

- The City Public Service Restated Decommissioning Master Trust for the South Texas Project (“28% Decommissioning Trust”), and
- The City Public Service Decommissioning Master Trust (TCC Funded) (“12% Decommissioning Trust”).

These two component units are collectively referred to herein as the “Decommissioning Trusts” or the “Trusts.”

The financial statements of the CPS Energy Pension Plan (“Plan”) are separately audited and reported as of a December 31 fiscal year-end. The financial results of the Plan are not included herein except for certain disclosures as provided in Note 9 – Employee Pension Plan and in the Required Supplementary Information (“RSI”) following the financial statement notes.

The CPS Energy Group Health, Group Life Insurance and Long-Term Disability Income Plans (collectively, “Employee Benefit Plans”) are separately audited and reported as of a December 31 fiscal year-end. The financial results of the Employee Benefit Plans are not included herein except for certain disclosures as provided in Note 10 – Other Postemployment Benefits and in the RSI following the financial statement notes.

Included in CPS Energy’s financial statements are the applicable financial results for 40% of the South Texas Project (“STP”) Units 1 and 2.

STP is a nonprofit special-purpose entity that reports under the guidance issued by the Financial Accounting Standards Board (“FASB”), including Topic 958 of the FASB Accounting Standards Codification, *Not-for-Profit Entities*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to STP’s financial information within CPS Energy’s financial statements for these differences.

**Fiscal Year (“FY”)** – The fiscal years ended January 31, 2018, and January 31, 2017, are referred to herein as “FY 2018” and “FY 2017,” respectively.

**Basis of Accounting** – The financial statements of CPS Energy are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) for proprietary funds of governmental entities. CPS Energy, including the Decommissioning Trusts, complies with all applicable pronouncements of GASB.

In accordance with the utility systems’ revenue bond ordinances, CPS Energy has adopted the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners (“NARUC”). The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

FY 2017 GASB pronouncement implementations:

- GASB Statement No. 77, *Tax Abatement Disclosures*, provides financial disclosure requirements for governments that enter into tax abatement agreements. This Statement indicates how disclosures for tax abatements should be organized and what descriptive information, including commitments made by the entity, should be presented. Since CPS Energy is not a tax-levying government and therefore is not a party to tax abatement agreements, there was no impact on the financial statements from implementation of this guidance.
- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, clarifies requirements for the application of GASB Statement No. 68 for certain governments whose employees receive pension benefits through multiple-employer plans. As CPS Energy does not sponsor benefits through the type of plan addressed by this Statement, the guidance is not applicable and has no impact on its financial reporting.
- GASB Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*, amends the blending requirements for the financial statement presentation of certain component units. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. There was no impact to CPS Energy’s financial statements from implementation of this guidance.
- GASB Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*, addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. This Statement did not have a significant impact on CPS Energy’s financial reporting.

FY 2018 GASB pronouncement implementations:

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, as they relate to certain other postemployment benefit (“OPEB”) plans that are administered through trusts or equivalent arrangements. This Statement requires more extensive note disclosures and RSI related to the measurement of the OPEB liabilities for which assets have been accumulated, including information about the annual money-weighted rates of

return on plan investments. This standard was implemented in their fiscal years ending December 31, 2017, by the CPS Energy-sponsored OPEB trusts.

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. This Statement establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, including the recognition and measurement of liabilities, deferred outflows of resources, deferred inflows of resources and expense. Additionally, Statement No. 75 sets forth note disclosure and required supplementary disclosure requirements for defined contribution OPEB. Refer to the subsequent page for description of effects of implementation of this standard.
- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, improves the accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. As CPS Energy is not the beneficiary of any irrevocable split-interest agreements, the guidance is not applicable and had no impact on its financial reporting.
- GASB Statement No. 85, *Omnibus 2017*, addresses a variety of topics and practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits. This Statement did not have a significant impact on CPS Energy's financial reporting.
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement did not have a significant impact on CPS Energy's financial reporting.

#### Future GASB pronouncement implementations:

- GASB Statement No. 83, *Certain Asset Retirement Obligations*, establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for legally enforceable asset retirement obligations and requires that recognition occur when the liability is both incurred and reasonably estimable. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2019. The Company has initiated an evaluation of the impact that adoption of this Statement will have on its financial statements.
- GASB Statement No. 84, *Fiduciary Activities*, establishes criteria for identifying fiduciary activities of all state and local governments for accounting and financial reporting purposes and how those activities should be reported. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2020. The Company has not yet determined the effect this Statement will have on its financial statements.
- GASB Statement No. 87, *Leases*, requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. The standard establishes a single model for lease accounting based on the foundational principle that leases are

financings of the right-to-use an underlying asset. Under the Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, which enhances the relevance and consistency of information about the Company's leasing activities. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2021. The Company has not yet determined the effect this Statement will have on its financial statements.

- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, requires additional essential information related to debt disclosure in the notes to the financial statements. Required disclosures include unused lines of credit, assets pledged as collateral for the debt, and terms specified in debt agreements which are related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. Under the Statement, direct borrowings and direct placement of debt is required to be reported separately from other debt. This standard will be adopted by CPS Energy in the fiscal year ending January 31, 2019. The Company has not yet determined the effect this Statement will have on CPS Energy's financial statements.

**Implementation of GASB Statement No. 75** – CPS Energy adopted the requirements of GASB Statement No. 75 in FY 2018. This statement provides guidance for the measurement and recognition of a net OPEB liability and OPEB expense, and includes instruction for balances to be recognized as deferred outflows of resources and deferred inflows of resources. The impact for CPS Energy is as follows:

**Net OPEB liability** – The net OPEB liability reported under GASB Statement No. 75 is the difference between the actuarial present value of projected OPEB benefit payments attributed to past periods of employee service and the OPEB plan's fiduciary net position. Previous to this new guidance, a liability was recognized only to the extent that contributions made to the plan were exceeded by the actuarially calculated contributions.

**Deferred outflows of resources and deferred inflows of resources** – GASB Statement No. 75 requires recognition of deferred outflows and inflows of resources associated with the difference between projected and actual earnings on plan investments, to be amortized to OPEB expense over a closed five-year period. Also to be recognized as deferred outflows and inflows of resources are differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total OPEB liability and changes of assumptions about future economic or demographic changes or other inputs, to be amortized to OPEB expense over a closed period equal to the average of the expected remaining service lives of all employees that are provided with OPEB benefits through the OPEB plan. Employer contributions to the OPEB trust made between the net OPEB liability measurement date and the employer's fiscal year end are recognized as deferred outflows of resources, to be included in OPEB expense in the subsequent fiscal year.

GASB Statement No. 75 is effective for financial statement periods beginning after June 15, 2017, with the effects of accounting change to be applied retroactively by restating the financial statements. CPS Energy adopted GASB Statement No. 75 in FY 2018 and, accordingly, has restated amounts of the affected balances within the financial statements for the period ended January 31, 2017, as follows:

(In thousands)	As Originally Reported	As Restated	Effect of Change
<b>Statement of Net Position</b>			
Noncurrent assets <sup>1</sup>			
Net OPEB obligation	\$ 14,435	\$ -	\$ (14,435)
Net OPEB liability	-	(19,791)	(19,791)
Total noncurrent assets	<u>14,435</u>	<u>(19,791)</u>	<u>(34,226)</u>
Deferred outflows of resources			
Unamortized loss on OPEB resources	-	31,013	31,013
Employer OPEB contributions	-	9,200	9,200
Total deferred outflows of resources	<u>-</u>	<u>40,213</u>	<u>40,213</u>
Net position	3,382,256	3,388,243	5,987
<b>Statement of Revenues, Expenses and Changes in Net Position</b>			
Operating expenses			
Operation and maintenance	507,478	514,824	7,346
Annual OPEB and pension expense	91,271	86,048	(5,223)

<sup>1</sup>The Net OPEB obligation previously reported under GASB Statement No. 45 was an asset balance as of January 31, 2017. With the adoption of GASB Statement No. 75, CPS Energy restated the Net OPEB liability and recorded a liability.

The following information is presented alphabetically:

**Allowance for Funds Used During Construction (“AFUDC”)** – To reflect funding methodology, the AFUDC rate includes both a debt and an equity component. The blended rate is composed of 50% equity and 50% debt based on construction funding forecasts. The investment rate is reviewed quarterly to determine if any adjustments are necessary. Alternate AFUDC rates are applied to projects costing more than \$100 million, reflecting the method by which they are funded.

**Build America Bonds (“BABs”)** – The American Recovery and Reinvestment Act (“ARRA”) of 2009 provided authority for the issuance of BABs, which were issuable in calendar years 2009 and 2010 as taxable bonds. The ARRA permitted the issuer or the issuer’s paying agent to receive subsidy payments equal to 35% of the bond’s interest costs directly from the U.S. Department of the Treasury. Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, the federal government reduced the BABs subsidy by 7.3% for payments made during the period October 1, 2014, through September 30, 2015. The subsidy was reduced by 6.8% from October 1, 2015, through September 30, 2016. The subsidy was reduced by 6.9% for payments made during the period October 1, 2016, through September 30, 2017. The subsidy is being reduced by 6.6% for payments made during the period October 1, 2017, through September 30, 2018. CPS Energy has taken the position that the BABs direct subsidy should be deducted when calculating debt service since the subsidy is received directly by a trustee to be used solely for BABs debt service payments. Transaction details for CPS Energy’s BABs issuances are provided in Note 6 – Revenue Bonds.

**Capital Assets** – The costs of additions and replacements of assets identified as major components or property units are capitalized. Maintenance and replacement of minor items are charged to operating expense. For depreciable assets that are retired due to circumstances other than impairment, the cost of the retired asset, plus removal costs and less salvage, is charged to accumulated depreciation. Per the financial reporting requirements of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, any losses associated with capital asset impairments will be charged to operations, not to accumulated depreciation.

A constructed utility plant is stated at the cost of construction, including expenditures for contracted services; equipment, material and labor; indirect costs, including general engineering, labor, equipment

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and material overheads; and AFUDC, or capitalized interest. AFUDC is applied to projects that require 30 days or more to complete.

Proceeds from customers to partially fund construction expenditures are reported as contributed capital in the Statements of Revenues, Expenses and Changes in Net Position as increases in net position in accordance with the requirements of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The amount reported for contributed capital was \$43.9 million for the period ended January 31, 2018, as compared with \$59.5 million at January 31, 2017. This included donated assets of \$2.6 million and \$5.9 million, respectively. The remaining portion of these balances, \$41.3 million for FY 2018, and \$53.6 million for FY 2017, represents contributions received from customers as payments for utility extensions and services, as well as funding for the Light Emitting Diode ("LED") streetlight project and the Dry Cask Storage Project.

Except for nuclear fuel, which is amortized over units of production, CPS Energy computes depreciation using the straight-line method over the estimated service lives of the depreciable property according to asset type. Total depreciation as a percent of total depreciable assets, excluding nuclear fuel, was 3.2% for FY 2018, and 3.4% for FY 2017.

The estimated useful lives of depreciable capital assets for FY 2018 and FY 2017 were as follows:

Depreciable Capital Asset	FY 2018	FY 2017
Buildings and structures	20–45 years	20–60 years
Systems and improvements		
Generation	18–49 years	18–60 years
Transmission and distribution	15–60 years	20–55 years
Gas	35–65 years	50–65 years
Intangibles - software	10 years	10 years
Intangibles - other	20–30 years	30 years
Machinery and equipment	4–20 years	4–30 years
Mineral rights and other	20–40 years	20–40 years
Nuclear fuel	Units of Production	Units of Production

In FY 2018, CPS Energy engaged an independent third-party consulting firm to conduct a depreciation study, which is performed every five years. The new depreciation rates resulting from the study were retroactively applied to the beginning of FY 2018. As a result of the study, based on the plant in service as of January 31, 2017, total annual depreciation decreased by approximately 3% based on the updated estimated useful lives.

Thresholds contained in the Company's capitalization policy, procedures and guidelines for both FY 2018 and FY 2017 were as follows:

Asset Class	Threshold
Land, land improvements and certain easements	Capitalize all
Buildings and building improvements	\$10,000
Computer software - purchased	50,000
Computer software - internally developed	50,000
Computer software - enhancements/upgrades	50,000
Computer hardware	3,000
All other assets	3,000

**Cash Equivalents and Investments, Unrestricted and Restricted** – CPS Energy’s investments with a maturity date within one year of the purchase date are reported at amortized cost, which approximates fair value. Amortization of premium and accretion of discount are recorded over the terms of the investments. CPS Energy’s investments with a maturity date longer than one year from the purchase date are accounted for at fair value. As available, fair values are determined by using generally accepted financial reporting services, publications and broker-dealer information. The specific identification method is used to determine costs in computing gains or losses on sales of securities. CPS Energy also reports all investments of the Decommissioning Trusts at fair value. Refer to Note 13 – Fair Value Measurement for additional information.

Restricted funds are generally for uses other than current operations. They are designated by law, ordinance or contract and are often used to acquire or construct noncurrent assets. Restricted funds consist primarily of unspent bond or commercial paper proceeds, debt service required for the New Series Bonds (senior lien obligations), Series Bonds (junior lien obligations), commercial paper, the flexible rate revolving note (“FRRN”) and funds for future construction or contingencies. Restricted funds also include customer assistance programs that receive proceeds from outside parties and the assets of the Decommissioning Trusts. Also included in the restricted funds classification is the Repair and Replacement Account, restricted in accordance with the Company’s bond ordinances.

Prior to February 1, 2012, 1% of the prior fiscal year’s electric base rate revenue was redesignated from the Repair and Replacement Account to the Community Infrastructure and Economic Development (“CIED”) Fund, which was used to support qualified capital projects that provided economic benefit within the communities served. Effective February 1, 2012, the CPS Energy Board of Trustees (“Board”) found that the objectives underlying the establishment of the CIED Fund had been successfully accomplished and authorized the termination of the policy providing for annual contributions to the fund.

Prior to FY 2014, in lieu of CIED funding, the City requested an equivalent amount of general funds to be transferred for its use. In such cases, the amount previously designated for CIED funding was returned to the Repair and Replacement Account and general funds were transferred to the City. Since the termination of the CIED Fund, CPS Energy sets aside 1% of prior fiscal year electric base rate revenue, which is transferred to the City on an annual basis as an additional transfer. In accordance with bond ordinances, the combined total of all payments to the City may not exceed 14% of gross revenues.

For additional disclosures provided in accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, see Note 2 – Cash, Cash Equivalents and Investments. These disclosures address investment exposure to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk, as applicable.

**Compensated Absences** – Employees earn vacation benefits based upon their employment status and years of service. As of January 31, 2018 and 2017, the accrued liabilities for those vested benefits were \$20.1 million and \$18.3 million, respectively, which were recorded as accrued liabilities on the Statements of Net Position.

**Decommissioning** – The Company accounts for decommissioning by recognizing a liability and an expense for a pro rata share of projected decommissioning costs as determined by the most recent cost study. A new cost study is performed every five years; and, in years subsequent to the latest study, estimated annual decommissioning expense and an increase in the liability is calculated by applying the effects of inflation and the ratio of years of plant usage to total plant life. The total decommissioning liability and related annual decommissioning expense is calculated assuming the longer total plant life due to the license extensions approved in FY 2018. See Note 14 – South Texas Project for additional details on the most recent cost study and license extensions.

Additionally, due to requirements under the Code of Federal Regulations governing nuclear decommissioning trust funds, a zero net position approach is applied in accounting for the Decommissioning Trusts. Accordingly, current year and prior year activity in the Trusts is reported in the nonoperating income (expense) section of the Statements of Revenues, Expenses and Changes in Net Position as decommissioning net costs recoverable (refundable). The cumulative effect of activity in the Trusts is reported on the Statements of Net Position as a noncurrent liability referred to as Decommissioning net costs refundable since any excess funds are payable to customers. Going forward, prolonged unfavorable economic conditions could result in the assets of the Trusts being less than the estimated decommissioning liability. In that case, instead of an excess as currently exists, there would be a deficit that would be reported as decommissioning net costs recoverable. This amount would be receivable from customers.

Currently, a project to develop an independent spent fuel storage installation (“Dry Cask Storage Project”) is under way at STP to provide for storage of spent nuclear fuel after the spent fuel pool has reached capacity. CPS Energy’s Decommissioning Trusts have separate spent fuel management accounts to pay for these costs. By contract, spent fuel will eventually be removed to final storage by the Department of Energy (“DOE”). The DOE failed to meet the contractual start date to receive spent fuel, and STP and other utilities have reached settlement agreements with the DOE. In the most recent settlement agreement dated March 15, 2017, the DOE extended its commitment to reimburse STP for allowable spent fuel management expenditures through 2019.

Ongoing costs for the spent fuel management project are being funded by the STP owners (CPS Energy; the City of Austin; and NRG South Texas LP, a wholly owned subsidiary of NRG Energy, Inc.) as expenditures are incurred. CPS Energy is entitled to request reimbursement at its discretion from its Decommissioning Trusts for the Company’s portion of allowable costs. Annually, the South Texas Project Nuclear Operating Company (“STPNOC”) submits claims to the DOE for the reimbursement of allowable costs for spent fuel management. Allowable costs are returned to the owners by STP upon receipt from the DOE. In turn, the settlement amount received from the DOE by CPS Energy is reimbursable to the Trusts. Qualifying spent fuel management costs not reimbursable by the DOE are funded by the Trusts. Spent fuel management costs that do not qualify for reimbursement by the DOE or the Trusts are recorded as operation and maintenance (“O&M”) expense or capital costs.

**Deferred Inflows of Resources** – Deferred inflows of resources related to pension amounted to \$50.5 million and \$43.3 million at January 31, 2018 and 2017, respectively. Deferred inflows of resources related to the sale of future revenue associated with the sale of the communication towers totaled \$3.3 million and \$4.3 million at January 31, 2018 and 2017, respectively.

Consistent with hedge accounting treatment required for derivative instruments that are determined to be effective in offsetting changes in the cash flows of the hedged item, changes in fair value are reported as deferred outflows or deferred inflows of resources on the Statements of Net Position until the expiration of the contract underlying the hedged expected fuel purchase transaction. When fuel hedging contracts expire, at the time the purchase transactions occur, the deferred balance is recorded as an adjustment to fuel expense. Deferred inflows of resources related to fuel hedges totaled \$2.8 million at January 31, 2018.

**Deferred Outflows of Resources** – Deferred outflows of resources related to pension amounted to \$89.4 million and \$204.1 million at January 31, 2018 and 2017, respectively. Deferred outflows of resources related to OPEB amounted to \$5.9 million and \$40.2 million at January 31, 2018 and 2017, respectively.

Deferred outflows of resources related to fuel hedges totaled \$6.9 million and \$7.8 million at January 31, 2018 and 2017, respectively.

For current and advance refundings of debt, the difference between the reacquisition price and the net carrying amount of the old debt is recorded as unamortized reacquisition costs and reported as deferred outflows of resources. These amounts are amortized as components of interest expense over the shorter of the remaining life of the refunding or the refunded debt. At January 31, 2018 and 2017, reacquisition costs totaled \$80.7 million and \$94.8 million, respectively.

**Federal Grant Programs** – Periodically, federal grants are made available to CPS Energy as a subrecipient for a portion of grant funds allocated to the state of Texas. Grant receipts are recorded as nonoperating income and generally reimburse CPS Energy for costs, recorded as operating expenses, incurred in the administration of the program. This accounting treatment results in no impact to the Company's net position. Revenues associated with the grant-related programs are exempt from payments of a percentage of gross revenues made to the City. Grant funding received by the Company is subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

**Flexible Rate Revolving Note Private Placement Program** – On January 20, 2009, the Board authorized the establishment of a FRRN program to provide additional liquidity in support of the Company's electric and gas systems ("Systems"). Under the program, the Company can issue taxable or tax-exempt notes with individual maturities of one year or less at fixed or variable interest rates in an aggregate principal amount at any one time outstanding not to exceed the currently effective limit of \$26 million, reduced in FY 2016 from \$100 million. The program became effective on April 28, 2009, and through annual renewals authorizes the issuance of such notes through November 1, 2028. The FRRN has been classified as short-term in accordance with the financing terms under the Note Purchase Agreement and is reported on the Statements of Net Position under current maturities of debt. The note outstanding under this program totaled \$25.2 million at January 31, 2018 and 2017. See Note 8 – Flexible Rate Revolving Note.

**Inventories** – CPS Energy maintains inventories for its materials and supplies and fossil fuels. In total, CPS Energy reported ending inventories of \$202.6 million and \$210.4 million at January 31, 2018 and 2017, respectively. Included in these amounts was CPS Energy's portion of STP inventories, which are valued at the lower of average cost or net realizable value. CPS Energy's directly managed inventories are valued using an average costing approach and are subject to write-off when deemed obsolete. As of January 31, 2018, CPS Energy has established a reserve for excess and obsolete inventory that is based on a combination of inventory aging and specific identification of items that can be written off. The reserve is intended to adjust the net realizable value of inventory CPS Energy may not be able to use due to obsolescence. The balance in the reserve was \$4.4 million on January 31, 2018.

**Long-Term Debt** – To support its long-term capital financing needs, CPS Energy uses several types of debt instruments. As of January 31, 2018 and 2017, these included fixed-rate and variable-rate bonds, as well as commercial paper. Relative to the bond instruments, provisions may be included that allow for refunding after specified time periods during the bond term.

Subject to applicable timing restrictions that may prevent early payoff, CPS Energy also has the option to defease or extinguish debt. A defeasance occurs when funds are placed in an irrevocable trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, which fully discharges the bond issuer's obligation. At the time of an extinguishment, since the issuer no longer has the legal obligation, the defeased debt is removed from the Statements of Net Position, the related unamortized costs are expensed, and the gain or loss is immediately recognized.

Current refundings involve issuing new debt (refunding bonds) to redeem existing debt (refunded bonds) that can be called within 90 days of the call date of the refunded bonds. Advance refunding of bonds involves issuing new debt to redeem existing debt that cannot be called within 90 days of issuing the

refunding bonds. In these circumstances, the refunding bond proceeds are irrevocably escrowed with a third party. These proceeds, and income thereon, are used to pay the debt service on the refunded bonds until the refunded bonds can be called. Refunding bonds are generally issued to achieve debt service savings. In December 2017, Congress passed the Tax Cuts & Jobs Act (“Act”). The Act preserved tax-exempt financing for municipal bonds but eliminated the use of advanced refundings at the end of calendar year 2017. See Note 6 – Revenue Bonds for information on current-year debt refundings.

Bond premiums and discounts are amortized using the effective interest method over the life of the related debt.

**Net Pension Liability** – A net pension liability is recorded in accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. The liability is the difference between the actuarial total pension liability and the Plan’s fiduciary net position as of the measurement date. The net pension liability was \$312.5 million and \$434.4 million at January 31, 2018 and 2017, respectively. For additional information, see Note 9 – Employee Pension Plan.

**Generation Asset Purchase** – In FY 2013, taxable senior lien bonds were issued to purchase the Rio Nogales combined-cycle natural gas electric generating plant in Seguin, Texas. The 800-MW plant was being utilized to provide a portion of its power to a third party that had executed a multiyear agreement, which expired in September 2015, for an option to call on power from the plant. Any remaining power was available for CPS Energy to sell into the Electric Reliability Council of Texas (“ERCOT”) market or to utilize to meet its commitments. As of February 1, 2016, CPS Energy integrated the Rio Nogales plant into its rate base to provide generation capacity that will not otherwise be available once J.T. Deely Units 1 and 2 are mothballed in FY 2019. In conjunction with the purchase, CPS Energy entered into a Tax Exemption Settlement Agreement in which CPS Energy agreed to pay \$25.5 million to certain parties to compromise, terminate claims and settle any disputes relating to exemption of ad valorem taxes involving the parties to this agreement. The payment was recorded as an intangible asset that is being amortized over the life of the agreement, which runs through December 2041.

**Other Noncurrent Assets** – Other noncurrent assets include prepayments, Save for Tomorrow Energy Plan (“STEP”) net costs recoverable, inventory relating to long-term service agreements (“LTSA”) and net OPEB (asset) liability. This section also includes a pension regulatory asset and unamortized bond expense discussed within the Regulatory Accounting topic below.

*Prepayments* – Included in prepayments is the balance related to an agreement entered into in November 2011, between the Company and SunEdison, for purchased power from San Antonio-area solar energy facilities with a total of 30 MW of capacity. In 2012, SunEdison sold the facilities to San Antonio Solar Holdings LLC; however SunEdison retained ownership of the land for one of the sites and continued as operator under an agreement with San Antonio Solar Holdings LLC. In FY 2013, \$77.0 million in prepayments were made for approximately 60% of the anticipated annual output over a period of 25 years. In April 2016, SunEdison filed Chapter 11 bankruptcy protection; however, CPS Energy had no remaining agreements directly with SunEdison and determined that the event had no impact on CPS Energy’s prepaid transaction. At January 31, 2018, of the remaining prepayment balance, \$3.1 million was classified as current and \$56.8 million was classified as noncurrent. At January 31, 2017, of the remaining prepayment balance, \$3.1 million was classified as current and \$59.9 million was classified as noncurrent. The purchase of the balance of the output is on a pay-as-you-go basis. As part of the agreement, CPS Energy has the right to purchase the facilities six years after commencement of commercial operation. During 2012, operations began for each of the three facilities that underlie the agreement.

*Save for Tomorrow Energy Plan* – Through STEP, CPS Energy has projected it will spend approximately \$849 million over a 13-year period, which began in FY 2009, on energy efficiency and conservation.

Contributing towards its goal to save 771 MW by 2020, CPS Energy's programs include home weatherization, higher efficiency light bulbs, solar rebates, peak saver thermostats, home area networks, demand response, rooftop and community solar programs, and other such initiatives.

Annually, approximately \$9.0 million of the STEP expenses are funded through the electric base rate and reported as O&M expenses. STEP expenses in excess of this initial amount per year are recovered through the fuel adjustment factor over a period of 12 months, or longer for certain STEP expenses, beginning in the subsequent fiscal year after they are incurred and have been independently validated. These STEP recoveries are accrued as a regulatory asset referred to as STEP net costs recoverable in accordance with guidance provided by GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This guidance permits certain costs to be capitalized as a regulatory asset until they are recovered through future rates.

*Inventory relating to long-term service agreements* – CPS Energy maintains LTSA arrangements with General Electric Inc. ("GE") to provide maintenance services and select replacement parts for certain combined-cycle power plants in CPS Energy's fleet. Per the maintenance schedules, Advanced Gas Path ("AGP") parts are delivered to the facilities. AGP parts not immediately required for maintenance procedures are recorded as inventory until the installation process for each set of parts at the power plant is initiated, at which time the parts are reclassified to capital assets. The liability for the purchase of the parts, along with other LTSA payment obligations are recorded as a liability on the Statements of Net Position. For additional information related to the LTSAs, see Note 11 – Other Obligations and Risk Management.

*Net OPEB (Asset) Liability* – A net OPEB (asset) liability is recorded in accordance with GASB Statement No. 75. The asset or liability is the difference between the actuarial total OPEB liabilities and the Employee Benefit Plans' fiduciary net positions as of the measurement date. The net OPEB (asset) liability was \$(26.2) million and \$19.8 million at January 31, 2018 and 2017, respectively. For additional information, see Note 10 – Other Postemployment Benefits.

**Other Noncurrent Liabilities** – Other noncurrent liabilities include the obligation for Project Warm resources held by the Company, the unrealized change in fair value of fuel hedges, unearned communication shelter revenue, miscellaneous unearned credits, long-term LTSA obligations and other liabilities for balances payable and deposits received.

**Rate Increases** – Rates are set by the Board and approved by the San Antonio City Council. On November 7, 2013, the City Council approved a 4.25% increase in both CPS Energy's electric and natural gas base rates, which were effective February 2014.

**Reclassifications** – Certain amounts in the prior year's financial statements have been reclassified to conform to the current-year presentation.

**Regulatory Accounting** – Regulatory accounting applies to governmental entities with rate-regulated operations, such as CPS Energy, that fall within the scope of GASB Statement No. 62. Regulatory accounting may be applied by entities, as approved by the governing body, to activities that have regulated operations that meet all required criteria. By establishing a regulatory asset, an entity seeks to recognize a cost over a future period of time and match recovery of those costs from its ratepayers to the amortization of the asset. An entity must demonstrate that adequate future revenue will result from inclusion of that cost in allowable costs for rate-making purposes.

Beginning in FY 2014, with the implementation of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, CPS Energy adopted the use of regulatory accounting to account for debt issuance costs. Prior to FY 2014, the Company had historically reported debt issuance costs as assets and

amortized them over the life of the related debt. Under GASB Statement No. 65, debt issuance costs no longer meet the definition of an asset, nor do they meet the definition of a deferred outflow of resources; therefore, they must be expensed in the period incurred. CPS Energy establishes regulatory assets for the debt issuance costs that GASB Statement No. 65 would otherwise require be expensed. This regulatory accounting treatment results in the amortization of these costs over the life of the related debt as the designated rate-recovery period. See Note 6 – Revenue Bonds for additional information.

The Company also elected to use regulatory accounting in conjunction with the implementation of GASB Statement No. 68 in FY 2015, which required immediate recognition of the Company's previously unrecognized net pension liability. For governmental entities other than those whose operations are rate regulated, the GASB Statement No. 68 adoption accounting required a charge to net position (equity) for the net effect of the restatements required to recognize the net pension liability. CPS Energy elected to use regulatory accounting, as allowed under GASB Statement No. 62, to create a regulatory asset representing the net effect of the prior period restatements, which totaled \$266.5 million and is being amortized over a rate-recovery period of 50 years. The amortization expense was \$5.3 million for FY 2018 and FY 2017, and is included in annual OPEB and pension expense on the Statement of Revenues, Expenses and Changes in Net Position. See Note 9 – Employee Pension Plan for additional information.

**Revenues and Expenses** – Revenues are recorded when earned. Customers' meters are read, or periodically estimated, and bills are prepared monthly based on billing cycles. Beginning in 2014, CPS Energy began replacing existing electric and gas meters with new "smart meters" that allow two-way communication between the meters and CPS Energy. One of the benefits of the smart meters is that they allow each meter to be read electronically without having to send a meter reader out to manually read each meter to determine the current billing period's electric or gas consumption. As of January 31, 2018, CPS Energy had completed 92% of its planned electric smart meter installations and 95% of its planned gas smart meter installations.

Rate tariffs include adjustment clauses that permit recovery of electric and gas fuel costs. CPS Energy uses historical information from prior fiscal years as partial bases to estimate and record earned revenue not yet billed (unbilled revenue). This process involves an extrapolation of customer usage over the days since the last meter read through the last day of the monthly period. Also included in unbilled revenue are the over/under-recoveries of electric and gas fuel costs and regulatory assessments. Unbilled revenue receivable recorded at January 31, 2018 and 2017, including estimates for electric fuel and gas costs, was \$47.7 million and \$27.7 million, respectively.

An adjustment clause in CPS Energy's rate tariffs also permits recovery of regulatory assessments. CPS Energy recovers assessments from the PUCT for transmission access charges and from the Texas Independent System Operator, also known as ERCOT, for its operating costs and other charges applicable to CPS Energy as a wholesale provider of power to other utilities. Regulatory assessments for FY 2018 and FY 2017 were \$84.1 million and \$75.0 million, respectively.

Operating revenues include receipts from energy sales, ancillary services and miscellaneous revenue, such as late payment fees and rental income, related to the operation of the Systems. Operating expenses are recorded as incurred and include those costs that result from the ongoing operations of the Systems.

Nonoperating income consists primarily of investment income, including fair value adjustments. Certain miscellaneous income amounts from renting general property and providing various services are also recorded as nonoperating income when they are not directly identified with the Systems. Beginning in FY 2015, rental income from the sale of communication towers is also included in nonoperating income.

**Service Concession Arrangement ("SCA")** – In accordance with GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, a service concession arrangement between

CPS Energy, owner, and Thousand Trails Management Services, Inc. (“TTMSI”), provider, was signed on November 20, 2009. TTMSI provides labor, supervision, management, services and equipment for Braunig Lake Park and Calaveras Lake Park, which are owned by CPS Energy. Gross receipts are distributed based on the contract agreement, which expires on November 30, 2024. CPS Energy is to retain ownership of both parks upon expiration of the arrangement.

At January 31, 2018 and 2017, a receivable was recorded in the amount of \$0.8 million and \$1.0 million, respectively, related to the TTMSI SCA. This balance represents the net amount of gross receipts less expenditures as of January 31, 2018 and 2017, respectively, for both parks. The asset book values as of January 31, 2018, for Braunig Lake Park and Calaveras Lake Park were \$0.9 million for each park.

**Statements of Cash Flows** – For purposes of reporting cash flows, CPS Energy considers all highly liquid debt instruments purchased with an original maturity of 90 days or less to be cash equivalents. CPS Energy’s Statements of Cash Flows separately list the noncash transactions.

**Use of Estimates** – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the amounts of revenues and expenses reported during the fiscal periods. Accordingly, actual results could differ from those estimates.

## **2. Cash, Cash Equivalents and Investments**

CPS Energy’s cash deposits at January 31, 2018 and 2017, were either insured by federal depository insurance or collateralized by banks. For deposits that were collateralized, the collateral included letters of credit and securities. The securities were U.S. Government, U.S. Government Agency or U.S. Government-guaranteed obligations held in book entry form by the Federal Reserve Bank of New York or other allowable banks in CPS Energy’s name.

**Separation** – CPS Energy’s cash, cash equivalents and investments can be separated in the following manner:

- Those directly managed by CPS Energy, and
- Those managed through the Decommissioning Trusts.

For financial reporting purposes, cash, cash equivalents and investments managed directly by CPS Energy have been consistently measured as of the end of the applicable fiscal years. The Decommissioning Trusts are reported on a calendar-year basis.

**Cash and Cash Equivalents**

(In thousands)

	January 31,	
	<u>2018</u>	<u>2017</u>
Cash		
Petty cash funds on hand (current)	\$ 53	\$ 74
Deposits with financial institutions		
Unrestricted CPS Energy deposits (current)	15,570	43,639
Restricted CPS Energy deposits (noncurrent)		
Capital projects	28	202
Debt service	582	1,229
Project Warm	260	204
Total cash	<u>16,493</u>	<u>45,348</u>
Cash equivalents		
Investments with original maturities of 90 days or less		
CPS Energy unrestricted (current)	189,795	147,779
CPS Energy restricted (noncurrent)	142,587	89,999
Decommissioning Trusts – restricted (noncurrent)	23,212	22,806
Total cash equivalents	<u>355,594</u>	<u>260,584</u>
Total cash and cash equivalents	<u>\$ 372,087</u>	<u>\$ 305,932</u>

**Summary of Cash, Cash Equivalents and Investments**

(In thousands)

	January 31,	
	<u>2018</u>	<u>2017</u>
Cash and cash equivalents		
CPS Energy – unrestricted and restricted	\$ 348,875	\$ 283,126
Decommissioning Trusts – restricted	23,212	22,806
Total cash and cash equivalents	<u>372,087</u>	<u>305,932</u>
Gross investments – current and noncurrent		
CPS Energy – unrestricted and restricted	1,050,431	917,817
Decommissioning Trusts – restricted	584,788	536,407
Total gross investments	<u>1,635,219</u>	<u>1,454,224</u>
Investments with original maturities of 90 days or less included in cash and cash equivalents		
CPS Energy – unrestricted and restricted	(332,382)	(237,779)
Decommissioning Trusts – restricted	(23,212)	(22,806)
Total cash equivalents	<u>(355,594)</u>	<u>(260,585)</u>
Net noncurrent investments	<u>1,279,625</u>	1,193,639
Total cash, cash equivalents and investments	<u>\$ 1,651,712</u>	<u>\$ 1,499,571</u>

**Public Funds Investment Act (“PFIA”)** – CPS Energy’s investments and the investments held in the Decommissioning Trusts are subject to the rules and regulations of the PFIA. The PFIA regulates what types of investments can be made, requires written investment policies, mandates training requirements of investment officers, requires internal management reports to be produced at least quarterly, and provides for the selection of authorized broker-dealers and investment managers.

**Investments of CPS Energy** – CPS Energy’s allowable investments are defined by Board resolution, CPS Energy Investment Policy, bond ordinances, commercial paper ordinances and state law. These investments are subject to market risk, and their fair value will vary as interest rates fluctuate. All CPS Energy investments are held in trust custodial funds by independent banks.

**SEC Rule 2a-7 Money Market Reform** – On July 23, 2014, the Securities and Exchange Commission adopted rule 2a-7 that governs money market funds. This rule was effective beginning October 14, 2016, and requires a floating net asset value (“NAV”) for institutional prime money market funds, which allows the daily share prices of these funds to fluctuate along with changes in the market-based value of the fund’s assets. The PFIA requires money market funds to have a stable \$1 NAV. Therefore, prior to rule 2a-7 becoming effective, CPS Energy was required to transfer its investments in institutional prime money market funds to investment types that have a stable \$1 NAV to remain in compliance with PFIA requirements. Permissible alternative investment types identified include government money market funds, investment pools, short-term commercial paper, and Treasury and Agency securities.

**Investments of the Decommissioning Trusts** – CPS Energy’s investments in the Decommissioning Trusts are held by an independent trustee. Investments are limited to those defined by Board resolution, the South Texas Project Decommissioning Trust Investment Policy, the Investment Committee, the Trust Agreements and state law, as well as PUCT and Nuclear Regulatory Commission (“NRC”) guidelines. Allowable investments for the Decommissioning Trusts include all types directly permissible for CPS Energy, except for investment pools. Additionally permitted are investments in equities and corporate bonds (including international securities traded in U.S. dollars and on U.S. stock exchanges). In accordance with the Trusts’ Investment Policy, total investments can include a maximum of 60% equity securities. In an effort to further reduce the overall risk of the portfolio, the target allocations for both Trusts are 63.5% fixed income, 28.0% equities and 8.5% U.S. real estate investment trusts.

### Permissible Investments

Investment Description	CPS Energy Investments	Decommissioning Trusts Investments
U.S. Government, U.S. Government Agency, or U.S. Government-guaranteed obligations	✓	✓
Collateralized mortgage obligations issued by the U.S. Government, or other obligations for which principal and interest are guaranteed by the U.S. or state of Texas	✓	✓
Fully secured certificates of deposit offered by a broker or issued by a depository institution that has its main office or branch office in the state of Texas	✓	✓
Direct repurchase agreements	✓	✓
Reverse repurchase agreements	✓	✓
Defined bankers’ acceptances and commercial paper	✓	✓
No-load money market mutual funds	✓	✓
Investment pools	✓	Not Permitted
Equities	Not Permitted	✓
Investment quality obligations of states, agencies, counties, cities and political subdivisions of any state	✓	✓
Corporate bonds	Not Permitted	✓
International securities	Not Permitted	✓
No-load commingled funds	Not Permitted	✓
Securities lending programs	✓	✓
Other specific types of secured or guaranteed investments	✓	✓

**Cash, Cash Equivalents and Investments by Fund**

(In thousands)

	January 31,	
	<u>2018</u>	<u>2017</u>
Unrestricted		
Cash and cash equivalents	\$ 205,418	\$ 191,492
Investments	<u>163,486</u>	<u>160,241</u>
Total unrestricted (current)	<u>368,904</u>	<u>351,733</u>
Restricted		
Debt service		
Cash and cash equivalents	<u>14,494</u>	<u>14,951</u>
Total debt service	<u>14,494</u>	<u>14,951</u>
Capital projects		
Cash and cash equivalents	<u>59,222</u>	<u>75,013</u>
Total capital projects	<u>59,222</u>	<u>75,013</u>
Ordinance		
Cash and cash equivalents	<u>69,463</u>	<u>1,449</u>
Investments	<u>547,205</u>	<u>512,443</u>
Total ordinance	<u>616,668</u>	<u>513,892</u>
Project Warm		
Cash and cash equivalents	<u>278</u>	<u>221</u>
Investments	<u>7,358</u>	<u>7,354</u>
Total Project Warm	<u>7,636</u>	<u>7,575</u>
Decommissioning Trusts		
Cash and cash equivalents	<u>23,212</u>	<u>22,806</u>
Investments	<u>561,576</u>	<u>513,601</u>
Total Decommissioning Trusts	<u>584,788</u>	<u>536,407</u>
Total restricted		
Cash and cash equivalents	<u>166,669</u>	<u>114,440</u>
Investments	<u>1,116,139</u>	<u>1,033,398</u>
Total restricted (noncurrent)	<u>1,282,808</u>	<u>1,147,838</u>
Total cash, cash equivalents and investments (unrestricted and restricted)	<u>\$ 1,651,712</u>	<u>\$ 1,499,571</u>

**Risk Exposure** – Cash equivalents, equity and fixed-income investments are exposed to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk) and foreign currency risk. Interest rate risk is the exposure to fair value losses resulting from rising interest rates. Credit risk is the risk that an issuer of an investment will not fulfill its obligations (will be unable to make timely principal and interest payments on the security). Foreign currency risk is the exposure to fair value losses arising from changes in exchange rates. Cash, cash equivalents and fixed-income investments are also exposed to inflation, liquidity, political, legal, event, reinvestment and timing (call) risks. Additionally, equity investments are exposed to political, legal, event, market and general economic risks. Due to market fluctuations, it is possible that substantial changes in the fair value of investments could occur after the end of the reporting period.

CPS Energy's investments and the investments in the Decommissioning Trusts are managed with a conservative focus. The Investment Policies are structured to ensure compliance with bond ordinances, the PFIA, the Public Funds Collateral Act, the NRC, the PUCT, other applicable state statutes and Board resolutions relating to investments. CPS Energy identifies and manages risks by following an appropriate investment oversight strategy, establishing and monitoring compliance with Investment Policies and procedures, and continually monitoring prudent controls over risks.

**Summary of Investments (Including Cash Equivalents)  
by Organizational Structure and Type<sup>1</sup>**  
(In thousands)

	January 31,	
	2018	2017
CPS Energy investments		
U.S. Treasuries, U.S. Agencies, municipal bonds, CDs, commercial paper, investment pools and money market mutual funds	<u>\$ 1,050,431</u>	<u>\$ 917,817</u>
Decommissioning Trusts		
U.S. Treasuries, U.S. Agencies, municipal bonds and money market mutual funds	219,005	211,131
Corporate bonds	130,092	123,398
Foreign bonds	<u>10,957</u>	<u>12,521</u>
Subtotal	<u>360,054</u>	347,050
Common stock	169,137	136,765
Real estate investment trusts	54,855	51,895
Preferred stock	<u>742</u>	<u>697</u>
Total Decommissioning Trusts	<u>584,788</u>	<u>536,407</u>
Total investments	<u>\$ 1,635,219</u>	<u>\$ 1,454,224</u>

<sup>1</sup>Excludes cash of \$16.5 million and \$45.3 million as of January 31, 2018 and 2017, respectively.

**Investment Policies** – In accordance with state law, the Trusts’ Investment Policy allows for investment in additional types of securities, such as corporate bonds and equity securities. The policy provides guidelines to ensure all funds are invested in authorized securities in order to earn a reasonable return. The primary emphasis is placed on long-term growth commensurate with the need to preserve the value of the assets and, at the time funds are needed for decommissioning costs, on liquidity. The Investment Policy continues to follow the “prudent person” concept.

**GASB Statement No. 40** – In accordance with GASB Statement No. 40, additional disclosures have been provided in this note that address investment exposure to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk, as applicable. CPS Energy’s investments and those in the Decommissioning Trusts do not have custodial credit risk, as all investments are held either by an independent trustee or bank and are in CPS Energy’s or the Decommissioning Trusts’ names.

### CPS Energy Investments

In accordance with GASB Statement No. 40, the following tables address concentration of credit risk and interest rate risk exposure by investment type using the weighted-average maturity (“WAM”) method. Since CPS Energy does not hold foreign instruments in its direct investments (those held by CPS Energy), foreign currency risk is not applicable.

**Interest Rate Risk** – In accordance with its Investment Policy, CPS Energy manages exposure to fair value losses resulting from rising interest rates by placing a limit on the portfolio’s WAM. The Investment Policy limits the WAM to three years or less, which allows for the management of risk while optimizing returns. CPS Energy invests in money market mutual funds that have no fixed maturities.

**Concentration of Credit Risk** – In accordance with its Investment Policy, CPS Energy manages exposure to concentration of credit risk through diversification and by limiting investment in each federal agency

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to 35% and investment in any other issuer of debt securities to 5% of the total fixed-income portfolio. Additionally, negotiable certificates of deposit are limited to 35% of the total portfolio per issuer.

Investment Type	January 31, 2018				January 31, 2017			
	Carrying Value	Fair Value	Allocation	WAM	Carrying Value	Fair Value	Allocation	WAM
U.S. Treasuries	\$ 27,472	\$ 27,472	2.62%	2.5	\$ 10,046	\$ 10,046	1.09%	0.4
U.S. Agencies								
Federal Agriculture Mtg Corp	24,813	24,813	2.36%	1.4	-	-	-	-
Federal Farm Credit Bank	97,858	97,858	9.32%	3.5	101,205	101,205	11.03%	3.8
Federal Home Loan Bank	98,372	98,372	9.36%	3.4	86,943	86,943	9.47%	4.1
Federal Home Loan Mortgage Corp	105,793	105,793	10.07%	4.1	126,866	126,866	13.83%	3.6
Federal National Mortgage Assn	118,673	118,673	11.30%	5.5	111,608	111,608	12.16%	5.1
Small Business Administration	32,382	32,382	3.08%	6.3	37,498	37,498	4.09%	6.8
Municipal bonds	152,918	152,917	14.56%	2.2	146,059	146,059	15.91%	2.0
Commercial paper	59,768	59,768	5.69%	0.2	59,813	59,813	6.52%	0.2
Investment pools	267,797	267,797	25.49%	-	117,776	117,776	12.83%	-
Money market mutual funds	64,585	64,585	6.15%	-	120,003	120,003	13.07%	-
Total fixed-income portfolio	<u>\$ 1,050,431</u>	<u>\$ 1,050,430</u>	<u>100.00%</u>	2.3	<u>\$ 917,817</u>	<u>\$ 917,817</u>	<u>100.00%</u>	2.5

**Credit Risk** – In accordance with its Investment Policy, CPS Energy manages exposure to credit risk by limiting long-term debt security investments to those with a credit rating of “A-” or better. As of January 31, 2018 and 2017, CPS Energy held no debt securities with a long-term credit rating below “A-” or equivalent, or a short-term credit rating below “A-1/P-1/F-1.”

Credit Rating	January 31, 2018			January 31, 2017		
	Carrying Value	Fair Value	Allocation	Carrying Value	Fair Value	Allocation
U.S. Treasuries (AA+)	\$ 27,472	\$ 27,472	2.62%	\$ 10,046	\$ 10,046	1.09%
AAA / Aaa	353,211	353,211	33.63%	259,331	259,331	28.26%
AA+ / Aa1	505,164	505,163	48.08%	489,024	489,024	53.27%
AA / Aa2	55,326	55,326	5.27%	47,622	47,622	5.19%
AA- / Aa3	20,038	20,038	1.91%	23,956	23,956	2.61%
A+ / A1	2,618	2,618	0.25%	1,503	1,503	0.16%
A / A2	1,407	1,407	0.13%	694	694	0.08%
A- / A3	-	-	-	632	632	0.07%
Short-term:						
A-1 / P-1 / F-1	59,768	59,768	5.69%	59,813	59,813	6.52%
Not rated <sup>1</sup>	25,427	25,427	2.42%	25,196	25,196	2.75%
Total fixed-income portfolio	<u>\$ 1,050,431</u>	<u>\$ 1,050,430</u>	<u>100.00%</u>	<u>\$ 917,817</u>	<u>\$ 917,817</u>	<u>100.00%</u>

<sup>1</sup> Money market deposit accounts, which meet PFIA/CPS Energy Investment Policy requirements.

## Decommissioning Trusts Investments

As mentioned previously, the Decommissioning Trusts report their assets on a calendar-year basis; therefore, information related to the Trusts is as of December 31, 2017 and 2016. The tables in this section address interest rate risk exposure by investment type, concentration of credit risk, credit risk and foreign currency risk. All investments held by the Decommissioning Trusts are long-term in nature and are recorded at fair value.

**Interest Rate Risk** – Generally, the long-term nature of the liabilities and the limited need for daily operating liquidity allow interim fluctuations in fair value to occur without jeopardizing the ultimate value of the assets. Where long-term securities are held, the interim fair value of assets can be sensitive to changes in interest rates. As the general level of interest rates moves up and down, the interim fair value of longer-maturity bonds may change substantially.

To mitigate interest rate risk, a limitation is placed on the weighted-average duration (“WAD”) of the fixed-income portfolio. The overall portfolio duration is limited by the Investment Policy to a deviation of no more than +/- 1.5 years from the WAD of the Investment Committee’s specified fixed-income index. The specified fixed-income index for the 28% Trust is Bloomberg Barclays US Aggregate, which was 5.91 for the period ending December 31, 2017. For the period ending December 31, 2016, the specified fixed-income index for the 28% Trust was Barclays Capital Aggregate, which was 5.89. The specified fixed-income index for the 12% Trust is Bloomberg Barclays US Aggregate, which was 5.91 for the period ending of December 31, 2017. For the period ending December 31, 2016, the specified fixed-income index for the 12% Trust was Barclays Capital Aggregate, which was 5.89.

**Concentration of Credit Risk** – In accordance with the Investment Policy, exposure to concentration of credit risk is managed through diversification and by limiting investments in each federal agency to 30% and investments in any other single issuer of debt securities to 5% of the total fixed-income portfolio. Likewise, equity investments are limited to 5% of the total portfolio for any one issuer. Total other debt securities (corporate and foreign issuers) amounted to 39.4% and 39.1% of the fixed-income portfolio for the 28% Decommissioning Trust at December 31, 2017 and 2016, respectively. Total other debt securities (corporate and foreign issuers) amounted to 38.6% and 39.2% of the fixed-income portfolio for the 12% Decommissioning Trust at December 31, 2017 and 2016, respectively.

The following table lists the fixed-income investment holdings by type:

Investment Type – 28% Trust	December 31, 2017			December 31, 2016		
	Fair Value	Allocation	WAD	Fair Value	Allocation	WAD
U.S. Treasuries	\$ 47,860	17.97%	10.0	\$ 44,577	17.36%	10.6
U.S. Agencies						
Federal National Mortgage Assn	32,435	12.18%	5.0	36,553	14.24%	4.6
Federal Home Loan Mortgage Corp	44,956	16.88%	4.4	39,460	15.37%	5.1
Federal Farm Credit Bank	5,656	2.12%	1.0	5,398	2.10%	1.0
Small Business Administration	3,995	1.50%	5.5	3,785	1.47%	5.6
Government National Mortgage Assn	2,699	1.01%	5.5	3,323	1.29%	5.6
Municipal bonds – Texas	1,228	0.46%	8.3	872	0.34%	8.1
Municipal bonds – other states	6,599	2.48%	9.2	6,555	2.55%	8.3
Corporate bonds	96,019	36.04%	6.1	90,395	35.20%	6.8
Foreign bonds	8,905	3.34%	5.7	10,105	3.94%	6.4
Money market mutual funds	16,040	6.02%	-	15,756	6.14%	-
Total 28% Trust fixed-income portfolio	<u>266,392</u>	100.00%	6.3	<u>256,779</u>	100.00%	6.7
<b>Investment Type – 12% Trust</b>						
U.S. Treasuries	15,563	16.62%	12.5	14,500	16.06%	14.1
U.S. Agencies						
Federal National Mortgage Assn	10,315	11.01%	4.8	11,968	13.26%	4.6
Federal Home Loan Mortgage Corp	14,726	15.72%	3.4	13,659	15.13%	4.2
Federal Farm Credit Bank	4,388	4.68%	0.7	2,477	2.74%	1.1
Small Business Administration	1,587	1.69%	5.4	1,343	1.49%	5.5
Government National Mortgage Assn	1,284	1.37%	5.5	1,582	1.75%	5.6
Municipal bonds – Texas	502	0.54%	7.9	416	0.46%	8.1
Municipal bonds – other states	2,000	2.14%	9.6	1,857	2.06%	8.5
Corporate bonds	34,073	36.38%	6.4	33,003	36.56%	6.8
Foreign bonds	2,052	2.19%	4.8	2,416	2.68%	5.9
Money market mutual funds	7,172	7.66%	-	7,050	7.81%	-
Total 12% Trust fixed-income portfolio	<u>93,662</u>	100.00%	6.5	<u>90,271</u>	100.00%	7.1
Total Trusts fixed-income portfolio	<u>\$ 360,054</u>			<u>\$ 347,050</u>		

**Credit Risk** – In accordance with the Investment Policy, exposure to credit risk is managed by limiting all fixed-income investments to a credit rating of “BBB-,” or equivalent, or better from at least two nationally recognized credit rating agencies. If a security’s rating falls below the minimum investment grade rating of “BBB-” after it has been purchased, the Investment Policy allows investment managers to continue to hold the security as long as the total fair value of securities rated below investment grade does not exceed

5% of the total fixed-income portfolio. As noted in the following tables, investments with a credit rating below “BBB-/Baa3” totaled 0.5% and 0.03% of the fixed-income portfolio for the 28% Trust and the 12% Trust, respectively, at December 31, 2017. There were no investments with a credit rating below “BBB- /Baa3” in either Trust at December 31, 2016.

The following table lists the fixed-income investment holdings by credit rating:

(Dollars in thousands)	December 31, 2017		December 31, 2016	
	Fair Value	Allocation	Fair Value	Allocation
<b>Credit Rating – 28% Trust</b>				
U.S. Treasuries (AA+)	\$ 47,860	17.97%	\$ 44,577	17.36%
AAA / Aaa	35,739	13.42%	37,658	14.67%
AA+ / Aa1	93,245	35.00%	91,793	35.74%
AA/Aa2	3,735	1.40%	3,419	1.33%
AA- / Aa3	5,725	2.15%	4,725	1.84%
A+ / A1	5,039	1.89%	2,209	0.86%
A/A2	12,005	4.51%	8,953	3.49%
A-/A3	12,664	4.75%	14,398	5.61%
BBB+/Baa1	22,809	8.56%	23,885	9.30%
BBB / Baa2	13,746	5.16%	16,483	6.42%
BBB-/Baa3	11,700	4.39%	7,646	2.98%
BB+/Ba1	871	0.33%	-	-
BB/Ba2	64	0.02%	-	-
BB-/Ba3	265	0.10%	-	-
Not Rated <sup>1</sup>	925	0.35%	1,033	0.40%
Total 28% Trust fixed-income portfolio	<u>266,392</u>	100.00%	<u>256,779</u>	100.00%
<b>Credit Rating – 12% Trust</b>				
U.S. Treasuries (AA+)	15,563	16.63%	14,500	16.06%
AAA / Aaa	16,727	17.86%	17,508	19.39%
AA+ / Aa1	34,106	36.41%	32,392	35.88%
AA / Aa2	866	0.92%	727	0.81%
AA-/Aa3	1,025	1.09%	1,536	1.70%
A+ / A1	2,120	2.26%	725	0.80%
A/A2	4,632	4.95%	4,194	4.65%
A-/A3	5,350	5.71%	5,615	6.22%
BBB+/Baa1	6,822	7.28%	7,643	8.47%
BBB/Baa2	3,679	3.93%	3,486	3.86%
BBB-/Baa3	2,044	2.18%	1,191	1.32%
BB/Ba2	27	0.03%	-	-
Not Rated <sup>1</sup>	701	0.75%	754	0.84%
Total 12% Trust fixed-income portfolio	<u>93,662</u>	100.00%	<u>90,271</u>	100.00%
Total Trusts fixed-income portfolio	<u>\$ 360,054</u>		<u>\$ 347,050</u>	

<sup>1</sup> The NDT Investment Managers are given discretion to invest in unrated securities that are of suitable quality and in line with their investment strategy, as long as those do not exceed the 10% limit prescribed for the portfolio by the NDT Investment Policy.

**Foreign Currency Risk** – With the exception of dedicated foreign-equity portfolios, all investments authorized for purchase by the Decommissioning Trusts are in U.S. dollars. This reduces the potential foreign currency risk exposure of the portfolio. All foreign bonds outstanding were issued in the U.S. and amounted to \$11.0 million at December 31, 2017, and \$12.5 million December 31, 2016. In accordance with the Investment Policy, investments in international equity securities are limited to international commingled funds, American Depository Receipts and exchange-traded funds that are diversified across

countries and industries. The international equity portfolio is limited to 20% of the total portfolio. Total foreign equity securities amounted to 14.4% and 12.3% of the 28% Trust's total portfolio at December 31, 2017 and 2016, respectively. Total foreign equity securities held by the 12% Trust amounted to 14.9% and 12.8% of the Trust's portfolio at December 31, 2017 and 2016, respectively.

### 3. Disaggregation of Current Accounts Receivable and Accounts Payable

**Accounts Receivable** – Net customer accounts receivable as of January 31, 2018, included \$47.7 million for unbilled revenue receivable and \$224.5 million for billed utility services. Interest and other accounts receivable included \$10.1 million for regulatory-related accounts receivable, \$0.2 million for interest receivable and \$36.7 million for other miscellaneous accounts receivable.

Net customer accounts receivable as of January 31, 2017, included \$27.7 million for unbilled revenue receivable and \$192.4 million for billed utility services. Interest and other accounts receivable included \$6.4 million for regulatory-related accounts receivable, \$0.1 million for interest receivable and \$38.1 million for other miscellaneous accounts receivable.

**Accounts Payable** – At January 31, 2018, accounts payable and accrued liabilities included \$223.2 million related to standard operating supplier and vendor accounts payable, including fuels payable; \$42.3 million for employee-related accounts payable; \$53.3 million for customer-related accounts payable; \$56.0 million for STP-related accounts payable; and \$50.8 million for other miscellaneous accounts payable and accrued liabilities.

At January 31, 2017, accounts payable and accrued liabilities included \$203.6 million related to standard operating supplier and vendor accounts payable, including fuels payable; \$43.4 million for employee-related accounts payable; \$51.0 million for customer-related accounts payable; \$54.9 million for STP-related accounts payable; and \$53.5 million for other miscellaneous accounts payable and accrued liabilities.

### 4. Capital Assets, Net

**General Description** – CPS Energy's plant-in-service includes four power stations that are solely owned and operated by the Company. In total, there are 19 generating units at these four power stations, four of which are coal-fired and 15 of which are gas-fired. Excluding STP (nuclear units), the following is a list of power stations and their respective generating units as of January 31, 2018:

<u>Power Station</u>	<u>Generating Units</u>	<u>Type</u>	<u>Power Station</u>	<u>Generating Units</u>	<u>Type</u>
Calaveras	6	Coal (4)/Gas (2)	Leon Creek	4	Gas
Braunig	8	Gas	Rio Nogales	1	Gas

In FY 2012, CPS Energy announced plans to mothball its J.T. Deely Units 1 and 2 coal-fired power plants in FY 2019 instead of the originally projected dates of FY 2032 and FY 2033, respectively. Therefore, depreciation for these two units was accelerated beginning in FY 2013. To continue operating the units past the announced mothball dates, the Company would have needed to install \$565 million in flue gas desulfurization equipment (commonly referred to as scrubbers) to cut SO<sub>2</sub> emissions in order to be compliant with more stringent environmental regulations that were expected to take effect in the future. The signing of the Energy Independence Executive Order in March 2017 dismantles much of the former Presidential Administration's environmental regulations, however, CPS Energy is still committed to shutting down its J.T. Deely Units 1 and 2 in FY 2019.

Other notable capital assets in electric and gas plant include supporting coal yard assets, a fleet of railcars, a transmission network for the movement of electric power from the generating stations to substations, electric and gas distribution systems, and metering. Included in general plant are two data centers; the main office complex; the construction and customer service centers; the Villita Assembly Building; and a fleet of automobiles, trucks and work equipment.

Intangible assets consist of easements, software, a tax exemption settlement and other intangible items.

**Communication Towers Sale** – In FY 2014, the Company entered into an agreement for \$41.0 million to sell 69 existing communication towers to an independent third party, including provisions for the Company’s continued use of select space on those towers, the purchaser’s use of space in the Company’s communication shelters located near the towers and the assignment of existing license agreements with other third parties using space on the towers. Title to 62 of the towers was conveyed to the purchaser in January 2014. As the towers are subject to group depreciation as permitted under guidance provided in GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, no gain or loss was recognized on the sale transaction. Instead, proceeds allocated to the sale were credited to accumulated depreciation. The costs of the assets sold were retired from the capital asset accounts in which they had originally been recorded.

Of the total purchase price, \$3.3 million was allocated to the seven towers not initially transferred to the purchaser pending resolution of easement issues and was recorded as a current liability. Additionally, the Company recorded as a current liability \$2.0 million of the total purchase price received out of escrow in FY 2015. This balance was available for the mitigation of easement issues related to the final seven towers. Final resolution of easement issues related to the seven towers not initially transferred to the purchaser was completed in early FY 2017, resulting in the conveyance of five of those towers. CPS Energy retained title to the remaining two towers and refunded the portion of the initial allocated purchase price to the purchaser. Upon completion of the FY 2017 transactions, the balance of the nonrefunded purchase price and unused escrow proceeds was reclassified from a current liability to accumulated depreciation. For information on lease transactions associated with the sale of the communication towers, see Note 16 – Leases.

**Plant Purchase** – In the first quarter of FY 2013, taxable senior lien bonds were issued to purchase the Rio Nogales combined-cycle natural gas electric generating plant in Seguin, Texas. The 800-MW plant was being utilized to provide a portion of its power to a third party that had executed a multiyear agreement, which expired in September 2015, for an option to call on power from the plant. Any remaining power was available for CPS Energy to sell into the ERCOT market or to utilize to meet its commitments. As of February 1, 2016, CPS Energy integrated the Rio Nogales plant into its rate base to provide generation capacity that will not otherwise be available once J.T. Deely Units 1 and 2 are mothballed in FY 2019.

In conjunction with the purchase, CPS Energy entered into a Tax Exemption Settlement Agreement in which CPS Energy agreed to pay \$25.5 million to certain parties to compromise, terminate claims and settle any disputes relating to exemption of ad valorem taxes involving the parties to this agreement. The payment was recorded as an intangible asset that is being amortized over the life of the agreement, which runs through December 2041.

The purchase price of the Rio Nogales plant was allocated to major subsets of assets including land, transmission lines, water treatment facilities, combustion and steam turbines, and switchyard assets. Other than the plant assets, the tax exemption settlement and normal working capital settlements, CPS Energy incurred no other material acquisition costs, nor did the Company assume any material liabilities with the purchase of the plant.

**Impairments** – During FY 2018, an impairment loss of \$2.5 million was recorded related to the Customer Relationship Management (“CRM”) Project due to permanent stoppage of the software development activities. The CRM Project would have enabled scalability within the call center with advancements to the Salesforce software currently being utilized by CPS Energy.

There were no capital asset impairments identified for FY 2017.

On October 29, 2007, the Board approved a resolution enabling CPS Energy to participate in development activities related to new nuclear generation units to be constructed near Bay City, Texas, on a site where STP Units 1 and 2 currently operate. These generation units are referred to as STP Units 3 and 4. At January 31, 2010, CPS Energy held a 50% interest in the development. As a result of a litigation settlement with the Company’s partner in the project, Nuclear Innovation North America, Inc. (“NINA”), CPS Energy’s ownership in STP Units 3 and 4 was reduced from 50% to 7.625% effective March 1, 2010. Effective as of FY 2012, AFUDC was not being recorded for the STP Units 3 and 4 project since efforts were limited to licensing-related activities. Including AFUDC of \$21.0 million, total project costs incurred by CPS Energy of \$391.4 million were previously reported on the Statements of Net Position as construction-in-progress.

In FY 2016, the Company reached the conclusion that as a result of sustained changes in a number of environmental and economic factors directly affecting the projected economic feasibility of completing construction of STP Units 3 and 4, the project had experienced a permanent impairment. The Company determined it was appropriate to write off the entire \$391.4 million investment in STP Units 3 and 4. The impairment loss was recorded as an extraordinary item on CPS Energy’s Statements of Revenues, Expenses and Changes in Net Position for the year ended January 31, 2016. For more detailed information on STP Units 3 and 4, see Note 14 – South Texas Project.

**Investment in STP Units 1 and 2** – STP is currently a two-unit nuclear power plant located in Matagorda County, Texas. It is maintained and operated by STPNOC, a nonprofit Texas corporation special-purpose entity, which is financed and controlled by the owners. CPS Energy’s 40% interest in STP Units 1 and 2 is included in plant assets. See Note 14 – South Texas Project.

**STP Capital Investment, Net**  
(Dollars in thousands)

	January 31,	
	2018	2017
STP capital assets, net		
Land	\$ 5,701	\$ 5,701
Construction-in-progress, STP Units 1 and 2	32,493	64,107
Electric and general plant	856,523	841,782
Intangibles	9,856	12
Nuclear fuel	121,903	130,673
Total STP capital assets, net	<u>\$ 1,026,476</u>	<u>\$ 1,042,275</u>
Total CPS Energy capital assets, net	<u>\$ 8,190,356</u>	<u>\$ 8,053,304</u>
STP capital investment as a percentage of total CPS Energy capital assets, net	12.5%	12.9%

**Capital Asset Rollforward** – The following tables provide more detailed information on the activity of CPS Energy’s net capital assets as presented on the Statements of Net Position, including capital asset activity for FY 2018 and FY 2017:

**FY 2018 Capital Asset Rollforward**  
(In thousands)

	February 1, 2017	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	January 31, 2018
<b>Nondepreciable assets</b>					
Land	\$ 87,889	\$ 24,508	\$ (15,272)	\$ -	\$ 97,125
Land easements	89,258	-	16,959	-	106,217
Construction-in-progress	622,296	414,972	(515,797)	-	521,471
Total nondepreciable assets	<u>799,443</u>	<u>439,480</u>	<u>(514,110)</u>	<u>-</u>	<u>724,813</u>
<b>Depreciable/amortizable assets</b>					
Electric plant	10,880,247	82,184	339,220	(64,193)	11,237,458
Gas plant	912,650	17,523	40,485	(512)	970,146
General plant	694,989	6,286	64,546	(29,216)	736,605
Intangibles					
Software	155,936	-	69,859	(16,065)	209,730
Other	28,704	9,844	-	-	38,548
Nuclear fuel	934,865	37,403	-	-	972,268
Total depreciable/ amortizable assets	<u>13,607,391</u>	<u>153,240</u>	<u>514,110</u>	<u>(109,986)</u>	<u>14,164,755</u>
<b>Accumulated depreciation and amortization</b>					
Electric plant	(4,906,904)	(329,531)	-	78,287	(5,158,148)
Gas plant	(356,088)	(21,030)	-	2,472	(374,646)
General plant	(230,002)	(54,554)	-	28,927	(255,629)
Intangibles					
Software	(51,013)	(19,125)	-	16,065	(54,073)
Other	(5,331)	(1,020)	-	-	(6,351)
Nuclear fuel	(804,192)	(46,173)	-	-	(850,365)
Total accumulated depreciation and amortization	<u>(6,353,530)</u>	<u>(471,433)</u>	<u>-</u>	<u>125,751</u>	<u>(6,699,212)</u>
Capital assets, net	<u>\$ 8,053,304</u>	<u>\$ 121,287</u>	<u>\$ -</u>	<u>\$ 15,765</u>	<u>\$ 8,190,356</u>

**Cash flow information** – Cash paid for additions and net removal costs totaled \$559.8 million. This amount includes \$545.5 million in additions to land, construction-in-progress and electric, gas and general plant, plus net salvage and removal costs of \$15.5 million, partially offset by \$12.6 million in AFUDC and \$2.6 million in donated assets.

**Other** – Depreciation and amortization expense for the period totaled \$425.3 million, while amortization of nuclear fuel of \$46.2 million was included in fuel expense on the Statements of Revenues, Expenses and Changes in Net Position.

**FY 2017 Capital Asset Rollforward**

(In thousands)

	February 1, 2016	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	January 31, 2017
<b>Nondepreciable assets</b>					
Land	\$ 71,164	\$ 3,118	\$ 13,753	\$ (146)	\$ 87,889
Land easements	88,699	-	559	-	89,258
Construction-in-progress	484,239	546,951	(408,894)	-	622,296
Total nondepreciable assets	<u>644,102</u>	<u>550,069</u>	<u>(394,582)</u>	<u>(146)</u>	<u>799,443</u>
<b>Depreciable/amortizable assets</b>					
Electric plant	10,585,886	77,555	296,743	(79,937)	10,880,247
Gas plant	859,883	19,524	33,850	(607)	912,650
General plant	678,721	9,241	50,998	(43,971)	694,989
Intangibles					
Software	174,747	1,358	12,991	(33,160)	155,936
Other	28,375	-	-	329	28,704
Nuclear fuel	865,458	69,407	-	-	934,865
Total depreciable/ amortizable assets	<u>13,193,070</u>	<u>177,085</u>	<u>394,582</u>	<u>(157,346)</u>	<u>13,607,391</u>
<b>Accumulated depreciation and amortization</b>					
Electric plant	(4,665,165)	(344,965)	-	103,226	(4,906,904)
Gas plant	(338,701)	(19,507)	-	2,120	(356,088)
General plant	(222,571)	(47,295)	-	39,864	(230,002)
Intangibles					
Software	(70,194)	(13,980)	-	33,161	(51,013)
Other	(3,989)	(1,012)	-	(330)	(5,331)
Nuclear fuel	(759,047)	(45,145)	-	-	(804,192)
Total accumulated depreciation and amortization	<u>(6,059,667)</u>	<u>(471,904)</u>	<u>-</u>	<u>178,041</u>	<u>(6,353,530)</u>
Capital assets, net	<u>\$ 7,777,505</u>	<u>\$ 255,250</u>	<u>\$ -</u>	<u>\$ 20,549</u>	<u>\$ 8,053,304</u>

**Cash flow information** – Cash paid for additions and net removal costs totaled \$654.0 million. This amount includes \$567.7 million in additions to construction-in-progress and electric, gas and general plant, plus net salvage and removal costs of \$15.9 million, partially offset by \$11.7 million in AFUDC and \$5.9 million in donated assets.

**Other** – Depreciation and amortization expense for the period totaled \$426.8 million, while amortization of nuclear fuel of \$45.1 million was included in fuel expense on the Statements of Revenues, Expenses and Changes in Net Position.

**5. Revenue Bond and Commercial Paper Ordinances Requirements**

**Senior Lien** – As of January 31, 2018, the bond ordinances for New Series Bonds contained, among others, the following provisions:

Revenue deposited in CPS Energy's General Account shall be pledged and appropriated to be used in the following priority for:

- Maintenance and operating expenses of the Systems;
- Payment of the New Series Bonds;
- Payment of prior lien bonds, including junior lien obligations;
- Payment of the notes and the credit agreement (as defined in the ordinance authorizing commercial paper);

- Payment of any inferior lien obligations issued, which are inferior in lien to the New Series Bonds, the prior lien bonds and the notes and credit agreement;
- An annual amount equal to 6% of the gross revenues of the Systems to be deposited in the Repair and Replacement Account;
- Cash payments and benefits to the General Fund of the City not to exceed 14% of the gross revenues of the Systems; and
- Any remaining net revenues of the Systems in the General Account to the Repair and Replacement Account, which is used to partially fund construction costs.

The maximum amount in cash to be transferred or credited to the City's General Fund from the net revenues of the Systems during any fiscal year shall not exceed 14% of the gross revenues of the Systems, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the fiscal year for additions to the street lighting system and other authorized exclusions. The percentage of gross revenues of the Systems to be paid over, or credited to, the City's General Fund each fiscal year shall be determined (within the 14% limitation) by the governing body of the City.

The net revenues of the Systems are pledged to the payment of principal and interest on the New Series Bonds, which are classified as senior lien obligations. All New Series Bonds and the interest thereon shall have a first lien upon the net revenues of the Systems.

**Junior Lien** – The Series Bonds are composed of two categories of debt: fixed-interest-rate and variable-interest-rate. The junior lien fixed-interest-rate Series Bonds are similar to the senior lien New Series Bonds, as they have fixed and set interest rates for the life of the bonds. The junior lien Variable-Rate Demand Obligations and Variable-Rate Note bonds are variable-interest-rate debt instruments of the City. The junior lien obligations are payable solely from, and equally and ratably secured by, a junior lien on and pledge of the net revenues of the Systems, subject and subordinate to liens and pledges securing the outstanding senior lien obligations and any additional senior lien obligations hereafter issued, and superior to the pledge and lien securing the currently outstanding commercial paper obligations, all as fully set forth in the ordinances authorizing the issuance of the junior lien obligations as noted below:

The City agrees that it will at all times maintain rates and charges for the sale of electric energy, gas or other services furnished, provided and supplied by the Systems to the City and all other consumers, which shall be reasonable and nondiscriminatory and which will produce income and revenues sufficient to pay:

- All operation and maintenance expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502 of the Texas Government Code, as amended;
- The interest on, and principal of, all parity bonds, as defined in the New Series Bond ordinances, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the parity bonds;
- The interest on, and principal of, the prior lien bonds, including the junior lien obligations and any additional junior lien obligations hereafter issued (all as defined in the New Series Bond ordinances), as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the junior lien obligations and any additional junior lien obligations;
- To the extent the same are reasonably anticipated to be paid with available revenues (as defined in the ordinance authorizing the commercial paper), the interest on and principal of all notes (as defined in said ordinance), and the credit agreement (as defined in said ordinance); and
- Any inferior lien obligations or any other legal debt or obligation of the Systems as and when the same shall become due.

**Commercial Paper** – As of January 31, 2018, the commercial paper ordinances contain, among others, the following provisions: authorized capacity of \$600 million, ability to issue tax-exempt or taxable commercial paper, ability to issue multiple series notes and final maturity on November 1, 2042.

To secure the payment of commercial paper principal and interest, a pledge is made of:

- Proceeds from
  - The sale of bonds and additional notes issued for such purposes, and
  - The sale of Project Notes;
- Loans under and pursuant to a revolving credit agreement;
- Amounts held in funds used specifically for payment of commercial paper principal and interest balances and unspent proceeds from commercial paper; and
- The net revenues of the Systems, after payment on New Series Bond requirements and prior lien bond obligations.

## 6. Revenue Bonds

On July 28, 2016, CPS Energy issued \$544.3 million of New Series 2016 Senior Lien Revenue Refunding Bonds. Proceeds, including the \$122.7 million premium associated with the bonds, were used to advance refund \$243.5 million and \$365.6 million par value of the New Series 2008 Revenue Bonds and New Series 2009A Revenue Refunding Bonds, respectively. Consequently, a portion of the New Series 2008 Revenue Bonds and New Series 2009A Revenue Refunding Bonds were considered defeased and were removed from the CPS Energy financial statements in FY 2017. The refunding transaction resulted in a net present value debt service savings of \$109.2 million, or 17.9% of the par value of the bonds being refunded. The true interest cost for this issue, which has maturities in 2020 through 2034, is 2.14%.

On December 1, 2016, CPS Energy remarketed \$47.5 million of Series 2012C Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$0.5 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$0.2 million. The bonds have maturities in 2024 through 2027. The coupon rate for these bonds is 2.0%, with a current yield of 1.50% and true interest cost of 6.40%, which reflects a stepped interest of 8.0% that is only applicable if the bonds are not remarketed before their expiration date.

On December 14, 2016, CPS Energy remarketed \$124.6 million of Series 2015A Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$1.1 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$0.4 million. The bonds have maturities in 2029 through 2033. The coupon rate for these bonds is 2.25%, with a current yield of 1.95% and true interest cost of 6.29%, which reflects a stepped interest of 8.0% that is only applicable if the bonds are not remarketed before their expiration date.

On April 27, 2017, CPS Energy issued \$308.0 million of New Series 2017 Senior Lien Revenue and Refunding Bonds. Proceeds, including the \$36.7 million premium associated with the bonds, are primarily being used to fund construction projects and were partially used to advance refund \$32.8 million and \$17.3 million par value of the New Series 2006B Revenue Refunding Bonds and New Series 2007 Revenue and Refunding Bonds, respectively. Consequently, the New Series 2006B Revenue Refunding Bonds and New Series 2007 Revenue and Refunding Bonds were considered defeased and were removed from the CPS Energy financial statements in FY 2018. The refunding transaction resulted in a net present value debt service savings of \$1.8 million, or 3.6% of the par amount of the bonds being refunded. The true interest cost for this issue, which has maturities in 2018 through 2047, is 3.77%.

On August 30, 2017, CPS Energy issued \$195.0 million of New Series 2017 Senior Lien Revenue Refunding Bonds. Proceeds, including the \$36.5 million premium associated with the bonds, were used to advance refund \$150.0 million and \$80.0 million par value of the Commercial Paper Series A and Commercial Paper

Series C, respectively. The true interest cost for this issue, which has maturities in 2026 through 2047, is 3.62%.

On September 14, 2017, CPS Energy remarketed \$123.3 million of Series 2015B Variable-Rate Junior Lien Revenue Refunding Bonds. The issuance of a \$2.3 million premium, in conjunction with the remarketing, resulted in a principal paydown for the remarketed bonds of approximately \$1.7 million. The bonds have maturities in 2029 through 2033. The coupon rate for these bonds is 2.0%, with a current yield of 1.48% and true interest cost of 4.92%, which reflects stepped interest rate provisions applicable to the bonds.

### Revenue Bond Summary

(Dollars in thousands)

	Issues	Maturities	Weighted-Average Yield on Outstanding Bonds at January 31, 2018	January 31,	
				2018	2017
Tax-exempt new series bonds	2009A-2017	2019-2047	4.1%	\$ 2,385,315	\$ 2,033,155
Taxable new series bonds	2009C <sup>1</sup> , 2010A <sup>1</sup> and 2012	2026-2042	4.1%	<u>1,276,000</u>	<u>1,276,000</u>
Total new series bonds			4.1%	<u>3,661,315</u>	<u>3,309,155</u>
Taxable series bonds	2010A <sup>1</sup> , 2010B <sup>1</sup>	2034-2041	3.9%	500,000	500,000
Tax-exempt variable-rate series bonds	2012A, 2012B, 2012C 2015A, 2015B, 2015C and 2015D	2024-2045	2.4%	590,115	591,840
Tax-exempt series bonds	2013, 2014	2019-2048	4.7%	<u>733,545</u>	<u>781,990</u>
Total series bonds			4.4%	<u>1,823,660</u>	<u>1,873,830</u>
Total long-term revenue bonds outstanding				5,484,975	5,182,985
Less: Current maturities of bonds				<u>169,895</u>	<u>156,810</u>
Total revenue bonds outstanding, net of current maturities				<u>\$ 5,315,080</u>	<u>\$ 5,026,175</u>

<sup>1</sup>Direct Subsidy Build America Bonds

**Build America Bonds Direct Subsidy** – The ARRA of 2009 provided authority for the issuance of BABs, which were issuable in calendar years 2009 and 2010 as taxable bonds. The ARRA permitted the issuer or the issuer’s paying agent to receive a subsidy payment equal to 35% of the bond’s interest directly from the U.S. Department of the Treasury.

Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, the federal government reduced the BABs subsidy by 7.3% for payments made during the period October 1, 2014, through September 30, 2015. The subsidy was reduced by 6.8% for payments made during the period October 1, 2015, through September 30, 2016. The subsidy was reduced by 6.9% for payments made during the period October 1, 2016, through September 30, 2017. For payments made during the period October 1, 2017, through September 30, 2018, the subsidy is being reduced by 6.6%. After a sequestration reduction totaling \$1.8 million, the total subsidy received for the 2009C and 2010A Senior Lien BABs and the 2010A and 2010B Junior Lien BABs was \$24.4 million for the year ended January 31, 2018. In FY 2017, the total subsidy received for the 2009C and 2010A Senior Lien BABs and the 2010A and 2010B Junior Lien BABs was \$24.3 million, which included a reduction totaling \$1.8 million in FY 2018.

As of January 31, 2018, principal and interest amounts due for all revenue bonds outstanding for each of the next five years and thereafter to maturity are:

(In thousands)

Fiscal Year	Principal	Interest	Direct Subsidy	Total
2019	\$ 169,895	\$ 260,707	\$ (24,407)	\$ 406,195
2020	180,085	261,817	(24,407)	417,495
2021	180,335	263,913	(24,407)	419,841
2022	198,860	261,070	(24,407)	435,523
2023	208,790	256,253	(24,407)	440,636
2024-2028	895,025	1,124,630	(126,347)	1,893,308
2029-2033	938,826	901,917	(130,659)	1,710,084
2034-2038	1,225,968	619,775	(96,381)	1,749,362
2039-2043	1,141,171	261,710	(18,645)	1,384,236
2044-2048	346,020	48,325	-	394,345
Totals	<u>\$ 5,484,975</u>	<u>\$ 4,260,117</u>	<u>\$ (494,067)</u>	<u>\$ 9,251,025</u>

The above table includes senior lien and junior lien bonds. Interest on the senior lien bonds and the junior lien fixed-rate bonds is based upon the stated coupon rates of each series of bonds outstanding. The direct subsidy associated with the BABs has been presented in a separate column and includes the impact of sequestration. CPS Energy has taken the position that the BABs direct subsidy should be deducted when calculating total debt service since the subsidy is received directly by the trustee to be used solely for BABs debt service payments.

The Series 2012A Junior Lien Bonds were issued as variable-rate bonds that utilize an interest rate of 2.0% through their term rate period's expiration in FY 2019. A stepped rate of 7.0% is assumed in the table above for this series thereafter through applicable final maturity. The Series 2012B bonds were issued as variable-rate bonds that utilize an interest rate of 1.75% through their term rate period's expiration in FY 2019. A stepped rate of 8.0% is assumed in the table above for this series thereafter through applicable final maturity. The Series 2012C Junior Lien Bonds were issued as variable-rate bonds that utilize an interest rate of 2.0% through their term rate period's expiration in FY 2019. A stepped rate of 8.0% is assumed in the table above for this series thereafter through applicable final maturity. The stepped rate is applicable only if the bonds are not remarketed by their respective expiration date.

The Series 2015A and Series 2015B Junior Lien Bonds were issued as multi-modal variable-rate bonds issued initially in a SIFMA Index Mode. The Series 2015A Junior Lien Bonds were remarketed in FY 2017 and issued as variable-rate bonds that utilize an interest rate of 2.25% through their term rate period's expiration in FY 2020. A stepped rate of 8.0% is assumed in the table above for this series thereafter through applicable final maturity. The Series 2015B Junior Lien Bonds were remarketed in FY 2018 and issued as variable-rate bonds that utilize an interest rate of 2.0% through their term rate period's expiration in FY 2022. A stepped rate of 7.0% is assumed in the table above for this series thereafter through applicable final maturity.

The Series 2015C and Series 2015D Junior Lien Bonds were issued as multi-modal variable-rate bonds initially issued in a term rate mode as variable-rate bonds that utilize an interest rate of 3.0% through their term rate period's expiration in FY 2020 and FY 2021, respectively. A stepped rate of 8.0% is assumed in the table above for each series thereafter through applicable final maturity. The stepped rate is applicable only if the bonds are not remarketed by their respective expiration date.

CPS Energy FY 2018 Basic Financial Statements

Pursuant to guidance provided in GASB Statement No. 65, debt reacquisition costs meet neither the definition of an asset nor a liability and are therefore required to be classified as deferred outflows or inflows of resources on the Statements of Net Position. The debt refundings that occurred in FY 2018 and FY 2017 resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately \$0.5 million and \$43.2 million, respectively. Debt reacquisition costs reported as deferred outflows of resources totaled \$80.7 million at January 31, 2018, and \$94.8 million at January 31, 2017. These amounts are amortized as components of interest expense using the effective interest method over the shorter of the remaining life of the refunding or the refunded debt.

CPS Energy, as a rate-regulated entity and in accordance with guidance found in GASB Statement No. 62, establishes regulatory assets for debt issuance costs that would otherwise be required to be expensed in accordance with GASB Statement No. 65. This regulatory accounting treatment results in the amortization of these costs over the life of the related debt. Debt issuance costs, which are reported within other noncurrent assets on the Statements of Net Position, totaled \$35.4 million at January 31, 2018, and \$34.6 million at January 31, 2017.

**FY 2018 Long-Term Debt Activity**

(Dollars in thousands)

	Original Amount	Final Principal Payment	True Interest Cost (%)	Balance Outstanding 2-1-17	Additions During Year	Decreases During Year	Balance Outstanding 1-31-18
Revenue and refunding bonds							
2006B tax-exempt	\$ 128,845	2021	3.974	\$ 32,800	\$ -	\$ (32,800)	\$ -
2007 tax-exempt	46,195	2018	4.159	16,630	-	(16,630)	-
2007 tax-exempt	403,215	2032	4.575	660	-	(660)	-
2008 tax-exempt	287,935	2032	4.582	20,470	-	(20,470)	-
2009A tax-exempt	442,005	2034	4.863	31,500	-	(15,380)	<b>16,120</b>
2009C taxable	375,000	2039	3.944	375,000	-	-	<b>375,000</b>
2009D tax-exempt	207,940	2021	3.720	175,935	-	(28,485)	<b>147,450</b>
2010A taxable	380,000	2041	3.834	380,000	-	-	<b>380,000</b>
2010A taxable - Junior Lien	300,000	2041	3.806	300,000	-	-	<b>300,000</b>
2010B taxable - Junior Lien	200,000	2037	4.101	200,000	-	-	<b>200,000</b>
2012 taxable	521,000	2042	4.382	521,000	-	-	<b>521,000</b>
2012 tax-exempt	655,370	2025	2.552	655,370	-	-	<b>655,370</b>
2012A tax-exempt - Junior Lien	48,170	2027	Variable	47,135	-	-	<b>47,135</b>
2012B tax-exempt - Junior Lien	47,815	2027	Variable	47,650	-	-	<b>47,650</b>
2012C tax-exempt - Junior Lien	47,660	2027	Variable	47,500	-	-	<b>47,500</b>
2013 tax-exempt - Junior Lien	375,000	2048	4.753	375,000	-	-	<b>375,000</b>
2014 tax-exempt - Junior Lien	200,000	2044	4.142	200,000	-	-	<b>200,000</b>
2014 tax-exempt - Junior Lien	262,530	2020	1.220	206,990	-	(48,445)	<b>158,545</b>
2015A tax-exempt - Junior Lien	125,000	2033	Variable	124,555	-	-	<b>124,555</b>
2015B tax-exempt - Junior Lien	125,000	2033	Variable	125,000	123,275	(125,000)	<b>123,275</b>
2015 tax-exempt	320,530	2032	2.992	320,530	-	(14,450)	<b>306,080</b>
2015 tax-exempt	235,000	2039	3.476	235,000	-	-	<b>235,000</b>
2015C tax-exempt - Junior Lien	100,000	2045	Variable	100,000	-	-	<b>100,000</b>
2015D tax-exempt - Junior Lien	100,000	2045	Variable	100,000	-	-	<b>100,000</b>
2016 tax-exempt	544,260	2034	2.144	544,260	-	-	<b>544,260</b>
2017 tax-exempt	40,685	2047	1.126	-	40,685	(21,950)	<b>18,735</b>
2017 tax-exempt	267,320	2047	3.804	-	267,320	-	<b>267,320</b>
2017 tax-exempt	194,980	2047	3.619	-	194,980	-	<b>194,980</b>
Bonds outstanding				<u>5,182,985</u>	<u>626,260</u>	<u>(324,270)</u>	<u>5,484,975</u>
Current maturities				(156,810)	(13,085)	-	<b>(169,895)</b>
(Discount) premium				330,138	75,534	(46,984)	<b>358,688</b>
Revenue bonds, net				<u>5,356,313</u>	<u>688,709</u>	<u>(371,254)</u>	<u>5,673,768</u>
Commercial paper, tax-exempt			Variable	360,000	30,000	(230,000)	<b>160,000</b>
Long-term debt, net				<u>\$ 5,716,313</u>	<u>\$ 718,709</u>	<u>\$ (601,254)</u>	<u>\$ 5,833,768</u>

**FY 2017 Long-Term Debt Activity**  
(Dollars in thousands)

	Original Amount	Final Principal Payment	True Interest Cost (%)	Balance Outstanding 2-1-16	Additions During Year	Decreases During Year	Balance Outstanding 1-31-17
Revenue and refunding bonds							
2006B tax-exempt	\$ 128,845	2021	3.974	\$ 44,510	\$ -	\$ (11,710)	\$ 32,800
2007 tax-exempt	46,195	2018	4.159	32,735	-	(16,105)	16,630
2007 tax-exempt	403,215	2032	4.575	24,045	-	(23,385)	660
2008 tax-exempt	287,935	2032	4.582	287,935	-	(267,465)	20,470
2009A tax-exempt	442,005	2034	4.863	411,810	-	(380,310)	31,500
2009C taxable	375,000	2039	3.944	375,000	-	-	375,000
2009D tax-exempt	207,940	2021	3.720	203,065	-	(27,130)	175,935
2010A taxable	380,000	2041	3.834	380,000	-	-	380,000
2010A taxable – Junior Lien	300,000	2041	3.806	300,000	-	-	300,000
2010B taxable – Junior Lien	200,000	2037	4.101	200,000	-	-	200,000
2011 tax-exempt	50,915	2017	1.599	15,420	-	(15,420)	-
2012 taxable	521,000	2042	4.382	521,000	-	-	521,000
2012 tax-exempt	655,370	2025	2.552	655,370	-	-	655,370
2012A tax-exempt – Junior Lien	48,170	2027	Variable	47,135	-	-	47,135
2012B tax-exempt – Junior Lien	47,815	2027	Variable	47,650	-	-	47,650
2012C tax-exempt – Junior Lien	47,660	2027	Variable	47,660	47,500	(47,660)	47,500
2013 tax-exempt – Junior Lien	375,000	2048	4.753	375,000	-	-	375,000
2014 tax-exempt – Junior Lien	200,000	2044	4.142	200,000	-	-	200,000
2014 tax-exempt – Junior Lien	262,530	2020	1.220	234,500	-	(27,510)	206,990
2015A tax-exempt – Junior Lien	125,000	2033	Variable	125,000	124,555	(125,000)	124,555
2015B tax-exempt – Junior Lien	125,000	2033	Variable	125,000	-	-	125,000
2015 tax-exempt	320,530	2032	2.992	320,530	-	-	320,530
2015 tax-exempt	235,000	2039	3.476	235,000	-	-	235,000
2015C tax-exempt – Junior Lien	100,000	2045	Variable	100,000	-	-	100,000
2015D tax-exempt – Junior Lien	100,000	2045	Variable	100,000	-	-	100,000
2016 tax-exempt	544,260	2034	2.144	-	544,260	-	544,260
Bonds outstanding				5,408,365	716,315	(941,695)	5,182,985
Current maturities				(160,000)	-	3,190	(156,810)
(Discount) premium				261,963	124,267	(56,092)	330,138
Revenue bonds, net				5,510,328	840,582	(994,597)	5,356,313
Commercial paper, tax-exempt			Variable	360,000	-	-	360,000
Long-term debt, net				<u>\$ 5,870,328</u>	<u>\$ 840,582</u>	<u>\$ (994,597)</u>	<u>\$ 5,716,313</u>

## 7. Commercial Paper and Related Revolving Credit Agreements

In 1988, the San Antonio City Council adopted an ordinance authorizing the issuance of up to \$300 million in tax-exempt commercial paper. The current ordinances allow for the issuance of three separate series of commercial paper to provide funding to assist in the interim financing of eligible projects in an aggregate amount not to exceed \$600 million to the extent of support from liquidity facilities. As of January 31, 2018, there was a total of \$600 million in liquidity support. The ordinances allow for the issuance of taxable, as well as tax-exempt commercial paper. Eligible projects include fuel acquisition, capital improvements to the Systems, and refinancing or refunding any outstanding obligations, which are secured by and payable from a lien and/or a pledge of net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of existing senior lien and junior lien obligations. Scheduled maximum maturities cannot extend beyond November 1, 2042.

The commercial paper has been classified as long-term in accordance with the refinancing terms under three revolving credit agreements with a consortium of banks, which support the commercial paper program. Each revolving credit agreement relates to a particular series of notes and provides liquidity support therefore in the amount specified. The Series A agreement, which provides \$150 million in liquidity support for the Series A Notes, is effective through February 6, 2019. The Series B agreement, which provides \$225 million in liquidity support for the Series B Notes, is effective through June 21, 2019.

The Series C agreement, which provides \$225 million in liquidity support for the Series C Notes, is effective through June 21, 2019. Under the terms of these revolving credit agreements, CPS Energy may borrow up to an aggregate amount not to exceed \$600 million for the purpose of paying principal due under the commercial paper program. At January 31, 2018, there was no amount outstanding under the revolving credit agreements. Further, there have been no borrowings under the agreements since inception of the program.

On August 30, 2017, outstanding amounts of \$150.0 million for Series A and \$80.0 million for Series C were refunded. On January 24, 2018, \$30.0 million from Series C was issued. As of January 31, 2018, the outstanding commercial paper balance was \$160.0 million, all of which was tax-exempt.

### Commercial Paper Summary

(Dollars in thousands)

	January 31,	
	<u>2018</u>	<u>2017</u>
Commercial paper outstanding	\$ 160,000	\$ 360,000
New commercial paper issues	\$ 30,000	\$ -
Weighted-average interest rate of outstanding	1.2%	0.8%
Average life outstanding (number of days)	60	55

## 8. Flexible Rate Revolving Note

In FY 2010, the San Antonio City Council adopted an ordinance authorizing the establishment of the FRRN Private Placement Program, under which CPS Energy may issue taxable or tax-exempt notes, bearing interest at fixed or variable rates in an aggregate principal amount at any one time outstanding not to exceed the currently effective limit of \$26 million, reduced in FY 2016 from \$100 million. This ordinance provides for funding to assist in the interim financing of eligible projects that include the acquisition or construction of improvements, additions or extensions to the Systems, including capital assets and facilities incident and related to the operation, maintenance and administration of fuel acquisition and development and facilities for the transportation thereof; capital improvements to the Systems; and refinancing or refunding of any outstanding obligations secured by the net revenues of the Systems; or with respect to the payment of any obligation of the Systems pursuant to any credit. Under the program, maturity dates cannot extend beyond November 1, 2028.

On May 10, 2010, CPS Energy issued a \$25.2 million taxable Flexible Rate Revolving Note, Series A, under its taxable Note Purchase Agreement with JPMorgan Chase Bank, N.A., which currently serves as the note purchaser under the program. On May 11, 2010, the proceeds from the note, along with cash, were used to defease \$25.7 million in principal amounts of the allocable portion of the debt associated with the common facilities of STP Units 1 and 2 that were assigned to NINA in March 2010 when CPS Energy reduced its ownership share of STP Units 3 and 4 to 7.625%. The outstanding FRRN balance at both January 31, 2018 and 2017, was \$25.2 million.

The FRRN has been classified as current in accordance with the financing terms under the taxable Note Purchase Agreement and is reported on the Statements of Net Position under current maturities of debt. At January 31, 2018, only the taxable facility was being utilized through the taxable Note Purchase Agreement. The taxable notes are being secured by a pledge of investment collateral and a limited, subordinate and inferior lien on and pledge of net revenues in the amount of \$0.1 million. The current taxable Note Purchase Agreement will expire on December 31, 2018, but through an annual renewal process may be extended through November 1, 2028.

## 9. Employee Pension Plan

**Plan Description** – The CPS Energy Pension Plan (the “Plan”) is a self-administered, single-employer, defined-benefit contributory pension plan covering substantially all employees who have attained age 21 and completed one year of service. It is sponsored by and may be amended at any time by CPS Energy, acting by and through the Employee Benefits Oversight Committee (“EBOC”), which includes the President and CEO, the Chief Financial Officer, and the Audit Committee of the Board. Plan assets are segregated from CPS Energy’s assets and are separately managed by the Administrative Committee, whose members are appointed by the EBOC. The Plan reports results on a calendar-year basis, and the separately audited financial statements, which contain historical trend information, may be obtained at [www.cpsenergy.com](http://www.cpsenergy.com) or by contacting Benefit Trust Administration at CPS Energy. The Plan’s financial statements include certain disclosures related to CPS Energy’s net pension liability. However, because the financial reporting and pension measurement dates for the Plan and CPS Energy are not aligned, the Plan’s disclosures will vary from information provided by CPS Energy in this footnote and in the accompanying RSI.

In addition to the defined-benefit Plan, CPS Energy has two Restoration Plans that were effective as of January 1, 1998, which supplement benefits paid from the Plan due to Internal Revenue Code restrictions on benefit and compensation limits. The benefits due under those Restoration Plans have been paid annually by CPS Energy.

Employees who retired prior to 1983 receive annuity payments from an insurance carrier, as well as some benefits directly from CPS Energy. The costs for the benefits directly received from the Company were \$0.02 million for FY 2018 and FY 2017. These costs were recorded when paid.

**Benefits Provided** – Participants become fully vested in the benefits of the Plan upon attainment of age 40 or after completion of seven years of vesting service before age 40. Normal retirement age is 65; however, early retirement is available with 25 years of benefit service, as well as to those employees who are age 55 or older with at least ten years of benefit service. Plan benefits consist of a normal retirement annuity calculated based primarily on length of service and compensation. Benefits are reduced for retirement before age 55 with 25 years or more of benefit service or before age 62 with less than 25 years of service. If early retirement occurs due to disability, the reductions in benefits normally associated with early retirement are modified.

Payments to retirees are adjusted each year by an amount equal to 50% of the change in the Consumer Price Index-U, limited to a maximum adjustment of 5% each year, with no reduction allowed below the retirees’ initial benefit levels.

The following table presents information about Plan participants covered by the benefit terms. Participants providing the basis of the actuarial valuations used to calculate the net pension liability, as of the measurement dates, for the fiscal years ended January 31, 2018 and 2017, were:

	January 31,	
	<u>2018</u>	<u>2017</u>
Active participants	2,860	2,830
Participants currently receiving benefits	2,360	2,345
Participants entitled to deferred benefits	<u>151</u>	<u>144</u>
Total plan participants	<u><u>5,371</u></u>	<u><u>5,319</u></u>

**Contributions** – The current policy of CPS Energy is to use an actuarial valuation as the basis for determining employer contributions to the Plan during the fiscal year beginning thirteen months after the valuation date. The January 1, 2016, valuation is the basis for contributions in FY 2018. With recommendations from the Administrative Committee, composed of a cross-functional group of active

and retired CPS Energy employees, the Company establishes funding levels, considering annual actuarial valuations. Generally, participating employees contribute 5.0% of their total compensation, commencing with the effective date of participation and continuing until normal or early retirement, completion of 44 years of benefit service, or termination of employment. Participants who leave CPS Energy service before becoming eligible for retirement benefits receive a return of the total amount they contributed to the Plan, plus the vested portion of accumulated interest. Beginning January 1, 2015, the employee contribution interest crediting rate was 5.50%.

The balance of Plan contributions is the responsibility of CPS Energy, giving consideration to actuarial information, budget controls, legal requirements, compliance, and industry and/or community norms. For FY 2018 and FY 2017, the amount to be funded was established using a general target near the 30-year funding contribution level as determined by the Plan's actuary using the entry-age normal cost method.

**Net Pension Liability** – CPS Energy's net pension liability at January 31, 2018 and 2017, was measured as of January 31, 2017 and 2016, respectively. The total pension liability used to calculate the net pension liability was determined by actuarial valuations as of January 1, 2016 and 2015, rolled forward using generally accepted actuarial procedures to the January 31, 2017 and 2016, measurement dates, respectively.

**Changes in Net Pension Liability**  
(In thousands)

	<u>Fiscal Year Ended January 31,</u>	
	<u>2018</u>	<u>2017</u>
<u>Total pension liability</u>		
Service cost	\$ 31,547	\$ 30,183
Interest cost	128,991	122,800
Changes in Plan benefits	-	-
Changes in assumptions	-	-
Differences between expected and actual experience	(18,647)	19,691
Benefit payments	<u>(91,230)</u>	<u>(91,293)</u>
Net change in total pension liability	50,661	81,381
Total pension liability, beginning of period	<u>1,734,177</u>	<u>1,652,796</u>
Total pension liability, end of period	<u>1,784,838</u>	<u>1,734,177</u>
<u>Plan fiduciary net position</u>		
Employer contributions	(44,500)	(46,000)
Participant contributions	(12,144)	(11,563)
(Earnings) loss on Plan assets	(207,196)	52,945
Benefit payments	<u>91,230</u>	<u>91,293</u>
Net change in Plan fiduciary net position	(172,610)	86,675
Plan fiduciary net position, beginning of period	<u>(1,299,766)</u>	<u>(1,386,441)</u>
Plan fiduciary net position, end of period	<u>(1,472,376)</u>	<u>(1,299,766)</u>
Net pension liability, end of period	<u>\$ 312,462</u>	<u>\$ 434,411</u>

CPS Energy recorded \$46.2 million and \$70.0 million in pension expense for the years ended January 31, 2018 and 2017, respectively.

**Actuarial Assumptions** – Significant actuarial assumptions used in the January 1, 2016, valuation include a rate of return on the investment of present and future assets of 7.50%, a discount rate on Plan liabilities

of 7.50%, annual projected salary increases averaging 4.66% per year and annual post-retirement cost-of-living increases of 1.5%. The projected salary increases include an inflation rate of 3.0%. Mortality rates were based on the RP-2000 Combined Healthy Annuitant Mortality Table for Males or Females, as appropriate, projected using Scale BB. There have been no significant changes to the actuarial assumptions used in the January 1, 2016, valuation compared to the January 1, 2015, valuation.

The actuarial assumptions used in the January 1, 2016 and 2015, valuations for amounts reported in FY 2018 and FY 2017, respectively, were based on the results of an actuarial experience study completed in 2014 covering experience for the period January 1, 2009, through December 31, 2013.

The long-term expected rate of return on Plan investments was determined based on a blend of historical performance data and future expectations for each major asset class, while also reflecting current capital market conditions, developed on a geometric basis. An economic simulation method was used in which best-estimate ranges of expected future rates of return (expected returns net of Plan investment expense) for each major asset class were combined using simulations that ensure the economic consistency of each individual trial, and then reduced by a factor representing inflation to produce long-term expected real rates of return for each major asset class. The assumed allocation and expected real rates of return for each major asset class are summarized in the following table:

Asset Class	Assumed Asset Allocation	Expected Real Rate of Return
Domestic equity	55.2%	5.5%
International equity	10.7%	5.4%
U.S. government and corporate bonds	19.6%	1.0%
Real estate	10.5%	3.8%
Cash equivalents	4.0%	-
Total investments	<u>100.0%</u>	

**Discount Rate** – The discount rate used to measure the total pension liability for FY 2018 and FY 2017 was 7.50%. The projection of cash flows used to determine the discount rate assumed that future employee contributions will be made at the current contribution rate and that future CPS Energy contributions will be made in a manner consistent with the current contribution practices. Based on those assumptions, the Plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on Plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

An actuarial experience study was completed in 2017 covering the period January 1, 2012, through December 31, 2016. As a result of the study, the discount rate was lowered to 7.25% to more closely reflect actual experience. This change in assumption will be reflected in the January 1, 2017, actuarial valuation with a measurement date of January 31, 2018, to be recorded in the fiscal year ending January 31, 2019.

The following table presents the sensitivity of net pension liability calculation to a 1% increase and a 1% decrease in the discount rate used to measure the total pension liability:

Discount rate	Discount Rate Sensitivity (In thousands)	
	Net Pension Liability at January 31,	
	2018	2017
1% decrease - 6.50%	\$533,656	\$ 642,862
Current discount rate - 7.50%	312,462	434,411
1% increase - 8.50%	125,823	255,003

**Plan Fiduciary Net Position** – Detailed information about the Plan’s fiduciary net position is available in the separately issued Plan financial statements. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, pension expense, information about the fiduciary net position for the Plan and additions to/deductions from the Plan’s fiduciary net position have been determined on the same basis as they are reported by the Plan. Investments are stated at fair value. Benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the terms of the Plan.

**Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension** – The following table presents information about the pension-related deferred outflows of resources and deferred inflows of resources for CPS Energy at January 31, 2018 and 2017:

(In thousands)

	January 31,	
	2018	2017
<u>Deferred outflows of resources</u>		
Differences between projected and actual earnings on pension assets	\$ -	\$ 104,589
Changes in assumptions	21,884	27,354
Differences between expected and actual experience in the measurement of total pension liability	21,253	27,660
Employer’s contributions to the Plan subsequent to the measurement of total pension liability	46,200	44,500
Total deferred outflows of resources	<u>\$ 89,337</u>	<u>\$ 204,103</u>
<u>Deferred inflows of resources</u>		
Differences between projected and actual earnings on pension assets	\$ (1,764)	\$ -
Differences between expected and actual experience in the measurement of total pension liability	(48,748)	(43,282)
Total deferred inflows of resources	<u>\$ (50,512)</u>	<u>\$ (43,282)</u>

The following table presents the future amortization of pension-related deferred outflows of resources and deferred inflows of resources, excluding the balance attributable to the employer’s contribution to the Plan in the current fiscal year and subsequent to the net pension liability measurement date. The deferred outflows of resources balance for such contribution amounts at the end of a fiscal period are recognized fully as adjustments to the net pension liability in the subsequent fiscal year.

**Amortization of Pension-Related Deferred Outflows/Inflows of Resources**  
(In thousands)

Year ended January 31,	
2019	\$ (935)
2020	11,937
2021	5,863
2022	(21,725)
2023	149
Thereafter	<u>(2,664)</u>
Total	<u>\$ (7,375)</u>

## 10. Other Postemployment Benefits

**Plan Descriptions** – The Company provides certain health and welfare benefits for active and retired employees through the CPS Energy Group Health, Group Life Insurance and Long-Term Disability Income Plans (collectively, “Employee Benefit Plans”). CPS Energy employees and their dependents may elect to participate in the plans and most employees continue eligibility upon retirement from the Company. Disclosures included in this footnote are limited to information related only to those benefits provided on a postemployment basis. Assets of the postemployment benefit plans are held in three separate, single-employer contributory plans:

- CPS Energy Group Health Plan (“Health Plan”)—a defined-benefit contributory group health plan that provides health, dental and vision insurance benefits.
- CPS Energy Group Life Insurance Plan (“Life Plan”)—a defined-benefit contributory plan that provides life insurance benefits.
- CPS Energy Long-Term Disability Income Plan (“Disability Plan”)—a defined-benefit contributory plan that provides disability income benefits.

The Employee Benefit Plans may be amended at any time by CPS Energy, acting by and through the EBOC, which includes the President and CEO, the Chief Financial Officer, and the Audit Committee of the Board.

The Employee Benefit Plans’ assets are segregated from CPS Energy’s assets and are separately managed by an Administrative Committee whose members are appointed by the EBOC. The plans report results on a calendar-year basis and issue separately audited financial statements that may be obtained by contacting Benefit Trust Administration at CPS Energy. The Employee Benefit Plans’ financial statements include certain disclosures related to CPS Energy’s net OPEB liabilities. However, because the financial reporting and OPEB measurement dates for the Employee Benefit Plans and CPS Energy are not aligned, the Employee Benefit Plans’ disclosures will vary from information provided by CPS Energy in this footnote and in the accompanying RSI.

**Benefits Provided** – The Health Plan provides health, dental and vision benefits to eligible retirees and the spouse and dependent children of deceased employees. The Life Plan provides life insurance benefits and death benefits to eligible retired employees and enrolled dependents. The Disability Plan provides disability income benefits to employees as of an employee’s date of hire; however, benefits under the Plan are reduced if the employee is receiving certain other disability, retirement or welfare benefits.

The following tables presents information about the Employee Benefit Plans participants covered by the benefit terms. Participants providing the basis of the actuarial valuations used to calculate the net OPEB liability, as of the measurement dates, for the fiscal years ended January 31, 2018 and 2017, were:

	<b>January 31, 2018</b>		
	<b>Health</b>	<b>Life</b>	<b>Disability</b>
Active participants	2,886	2,886	2,992
Participants currently receiving benefits	-	2,268	69
Retirees receiving medical and vision	1,926	-	-
Retirees receiving dental	1,863	-	-
Total plan participants	<u>6,675</u>	<u>5,154</u>	<u>3,061</u>

	January 31, 2017		
	Health	Life	Disability
Active participants	2,883	2,831	2,963
Participants currently receiving benefits	-	2,267	53
Retirees receiving medical and vision	2,048	-	-
Retirees receiving dental	1,959	-	-
Total plan participants	<u>6,890</u>	<u>5,098</u>	<u>3,016</u>

**Contributions** – The funding requirements for both the plan participants and the employer are established by and may be amended by CPS Energy. Funding is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the Company. The current policy of CPS Energy is to use each actuarial valuation as the basis for determining monthly employer contributions to the Employee Benefit Plans during the fiscal year beginning thirteen months after the valuation date. The January 1, 2016, valuation was the basis for contributions in FY 2018.

Retired employees contribute to the Health Plan in varying amounts depending upon an equity formula that considers age and years of service. Individuals who retired before February 1, 1993, contribute a base rate plus 2.25% of the difference between that amount and the aggregate rate for each year that the sum of age and service is less than 95. Those who retired on or after February 1, 1993, contribute a base rate plus a percentage of the CPS Energy contribution, based on the number of years of service, if they retire with less than 35 years.

Based on the funded status of the Health Plan, the Company made no contributions in FY 2018. The Company's average contribution rate of the Health plan was 3.8% of covered payroll in FY 2017.

The Medicare Prescription Drug Improvement and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D entitled the Health Plan to receive retiree drug subsidy payments from the federal government to offset pharmacy claims paid by the Health Plan on behalf of certain plan participants. These payments totaled \$0.9 million and \$1.0 million for FY 2018 and FY 2017, respectively. In accordance with GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*, future projected payments from the federal government have not been used to lessen total projected obligations under the Company's Health Plan.

Active employees contribute to the Life Plan at a rate of \$0.13 per \$1,000 of insurance per month on amounts in excess of \$20,000. Individuals who retired prior to February 1, 1993, contribute at a rate of \$0.13 per \$1,000 of insurance per month on amounts in excess of \$20,000 plus 2.25% of the difference

between that amount and the aggregate rate for retiree coverage for each year the sum of retirement age and service is less than 95. Those who retired on or after February 1, 1993, contribute \$0.13 per \$1,000 of insurance per month on amounts in excess of \$20,000 plus a percentage of the CPS Energy contribution, based on number of years of service, if they retire with less than 35 years. Based on the funded status of the Life Plan, the Company made no contributions in FY 2018 and FY 2017.

Beginning February 1, 2014, the Disability Plan is funded by a combination of employee and employer contributions. Active employee contribution rates are determined by CPS Energy and may be adjusted on an annual basis. The Company's contributions are determined on a discretionary basis and are generally based on actuarial valuation calculations. Retired employees are not eligible to participate and therefore do not contribute to the Disability Plan. Prior to FY 2015, the Disability Plan was funded completely by CPS Energy. The Company's average contribution rate was 0.6% of covered payroll in FY 2018 and 0.3% of covered payroll in FY 2017.

**Net OPEB (Asset) Liability** – CPS Energy's net OPEB (asset) liability at January 31, 2018 and 2017, was measured as of January 31, 2017 and 2016, respectively. The total OPEB liability used to calculate the net OPEB (asset) liability was determined by actuarial valuations as of January 1, 2017 and 2015, rolled forward using generally accepted actuarial procedures to the January 31, 2017 and 2016, measurement dates, respectively.

### FY 2018 Changes in Net OPEB (Asset) Liability

(In thousands)

	Health	Life	Disability	Total
<b>Total OPEB liability</b>				
Service cost	\$ 3,435	\$ 336	\$ 527	\$ 4,298
Interest cost	18,176	3,256	455	21,887
Changes in Plan benefits	(19,185)	-	-	(19,185)
Changes in assumptions	-	-	-	-
Differences between expected and actual experience	475	2,378	255	3,108
Benefit payments	(14,001)	(3,469)	(974)	(18,444)
Net change in total OPEB liability	(11,100)	2,501	263	(8,336)
Total OPEB liability, beginning of period	245,908	44,788	6,032	296,728
Total OPEB liability, end of period	234,808	47,289	6,295	288,392
<b>Plan fiduciary net position</b>				
Employer contributions	(8,500)	-	(700)	(9,200)
Participant contributions	(6,802)	(972)	(260)	(8,034)
Medicare Part D payment	(933)	-	-	(933)
(Earnings) loss on Plan assets	(38,949)	(6,936)	(501)	(46,386)
Benefit payments	20,804	3,469	974	25,247
Administrative expense	1,621	27	15	1,663
Net change in Plan fiduciary net position	(32,759)	(4,412)	(472)	(37,643)
Plan fiduciary net position, beginning of period	(227,889)	(45,286)	(3,762)	(276,937)
Plan fiduciary net position, end of period	(260,648)	(49,698)	(4,234)	(314,580)
Net OPEB (asset) liability, end of period	\$ (25,840)	\$ (2,409)	\$ 2,061	\$ (26,188)

**FY 2017 Changes in Net OPEB (Asset) Liability**

(In thousands)

	Health	Life	Disability	Total
<b>Total OPEB liability</b>				
Service cost	\$ 3,319	\$ 325	\$ 509	\$ 4,153
Interest cost	17,601	3,244	448	21,293
Changes in Plan benefits	-	-	-	-
Changes in assumptions	-	-	-	-
Differences between expected and actual experience	-	-	-	-
Benefit payments	<u>(12,756)</u>	<u>(3,358)</u>	<u>(775)</u>	<u>(16,889)</u>
Net change in total OPEB liability	8,164	211	182	8,557
Total OPEB liability, beginning of period	<u>237,744</u>	<u>44,577</u>	<u>5,850</u>	<u>288,171</u>
Total OPEB liability, end of period	<u>245,908</u>	<u>44,788</u>	<u>6,032</u>	<u>296,728</u>
<b>Plan fiduciary net position</b>				
Employer contributions	(8,806)	-	(175)	(8,981)
Participant contributions	(6,734)	(930)	(248)	(7,912)
Medicare Part D payment	(976)	-	-	(976)
(Earnings) loss on Plan assets	9,765	2,102	158	12,025
Benefit payments	19,490	3,358	775	23,623
Administrative expense	<u>1,456</u>	<u>21</u>	<u>14</u>	<u>1,491</u>
Net change in Plan fiduciary net position	14,195	4,551	524	19,270
Plan fiduciary net position, beginning of period	<u>(242,084)</u>	<u>(49,837)</u>	<u>(4,286)</u>	<u>(296,207)</u>
Plan fiduciary net position, end of period	<u>(227,889)</u>	<u>(45,286)</u>	<u>(3,762)</u>	<u>(276,937)</u>
Net OPEB (asset) liability, end of period	<u>\$ 18,019</u>	<u>\$ (498)</u>	<u>\$ 2,270</u>	<u>\$ 19,791</u>

CPS Energy recorded \$(10.4) million and \$10.8 million in OPEB expense for the years ended January 31, 2018 and 2017, respectively.

**Actuarial Assumptions** – Significant actuarial assumptions used in the calculations for the January 1, 2017, actuarial valuation for FY 2018 included: (a) a rate of return on the investment of present and future assets of 7.50% for the Health, Life and Disability Plans, (b) a Consumer Price Index increase of 3.0% per year for the Life and Disability Plans, (c) projected annual base salary increases for the Health Plan ranging from 4.0% to 9.5% depending on age and projected average annual salary increases of 4.78% for the Life and Disability Plans, and (d) overall medical and prescription cost increases projected at 7.0% for 2017, decreasing annually to 5.0%, in 2022 and thereafter. Mortality rates for retirees were based on the RP-2000 Combined Healthy, with No Collar Adjustment, Projected to 2020 using Scale BB, Male and Female tables. Mortality rates for disabled lives were based on the 1987 Commissioners Group Disabled Life Mortality Table. There were no significant changes to the January 1, 2017, valuation assumptions, compared to the January 1, 2015, valuation for the Life and Disability Plans. The January 1, 2017, valuation for the Health Plan includes updated claims costs to reflect plan changes and recent experience, as well as resetting of the medical and prescription costs trend.

The actuarial assumptions used in the January 1, 2017 and 2015, valuations for amounts reported in FY 2018 and FY 2017, respectively, were based on the results of an actuarial experience study completed in 2014 covering experience for the period January 1, 2009, through December 31, 2013.

The long-term expected rate of return on OPEB plan investments was determined based on a blend of historical performance data and future expectations for each major asset class, while also reflecting current capital market conditions, developed on a geometric basis. An economic simulation method was

used in which best-estimate ranges of expected future rates of return (expected returns on Employee Benefit Plans investment expense) for each major asset class were combined using simulations that ensure the economic consistency of each individual trial, then reduced by a factor representing inflation to produce long-term expected real rates of return for each major asset class. The assumed allocation and expected real rates of return for each major asset class are summarized in the following table:

Asset Class	Assumed Asset Allocation	Expected Real Rate of Return
Domestic equity	55.2%	5.5%
International equity	10.7%	5.4%
U.S. government and corporate bonds	19.6%	1.0%
Real estate	10.5%	3.8%
Cash equivalents	4.0%	-
Total investments	<u>100.0%</u>	

**Discount Rate and Healthcare Cost Trend Rates** – The discount rate used to measure the total OPEB liability for FY 2018 and FY 2017 was 7.50%. The projection of cash flows used to determine the discount rate assumed that CPS Energy contributions will be made in a manner consistent with the current contribution practices. Based on those assumptions, the OPEB plan’s fiduciary net position was projected to be available to make all projected OPEB payments for current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

An actuarial experience study was completed in 2017 covering the period January 1, 2012, through December 31, 2016. As a result of the study, the discount rate was lowered to 7.25% to more closely reflect actual experience. This change in assumption will be reflected in the January 1, 2017, actuarial valuation with a measurement date of January 31, 2018, to be recorded in the fiscal year ending January 31, 2019.

The following tables present the sensitivity of net OPEB (asset) liability calculation to a 1% increase and a 1% decrease in the discount rate used to measure the total OPEB liability:

#### Discount Rate Sensitivity

(In thousands)

	Net OPEB (Asset) Liability at January 31, 2018			
	Health	Life	Disability	Total
<u>Discount rate</u>				
1% decrease - 6.50%	\$ 2,203	\$ 4,135	\$ 2,219	\$ 8,557
Current discount rate - 7.50%	(25,840)	(2,409)	2,061	(26,188)
1% increase - 8.50%	(53,883)	(8,639)	1,911	(60,611)

	Net OPEB (Asset) Liability at January 31, 2017			
	Health	Life	Disability	Total
<u>Discount rate</u>				
1% decrease - 6.50%	\$ 47,456	\$ 5,700	\$ 2,420	\$ 55,576
Current discount rate - 7.50%	18,019	(498)	2,270	19,791
1% increase - 8.50%	(11,415)	(6,398)	2,125	(15,688)

The following table presents the sensitivity of net Health Plan OPEB (asset) liability calculation to a 1% increase and a 1% decrease in the healthcare cost trend rates used to measure the total Health Plan OPEB liability:

**Healthcare Cost Trend Rates Sensitivity**  
(In thousands)

<u>Healthcare Cost Trend Rates</u>	Net Health Plan OPEB (Asset) Liability at January 31,	
	2018	2017
	1% decrease - 6.50% decreasing to 4.00%	<b>\$ (51,252)</b>
7.50% decreasing to 5.00%	<b>(25,840)</b>	18,019
1% increase - 8.50% decreasing to 6.00%	<b>4,508</b>	49,876

**Plan Fiduciary Net Position** – Detailed information about the OPEB plans’ fiduciary net position is available in the separately issued Employee Benefit Plans financial statements. For purposes of measuring the net OPEB (asset) liability, deferred outflows of resources and deferred inflows of resources related to OPEB, OPEB expense, information about the fiduciary net position for the Employee Benefit Plans and additions to/deductions from the Employee Benefit Plans’ fiduciary net position have been determined on the same basis as they are reported by the Employee Benefit Plans. Investments are stated at fair value. Benefit payments are recognized when due and payable in accordance with the terms of the Employee Benefit Plans.

**Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB** – The following tables present information about the OPEB-related deferred outflows of resources and deferred inflows of resources for CPS Energy at January 31, 2018 and 2017:

(In thousands)

	January 31, 2018			
	Health	Life	Disability	Total
<u>Deferred outflows of resources</u>				
Differences between projected and actual earnings on OPEB assets	\$ 787	\$ 1,019	\$ 159	<b>\$ 1,965</b>
Differences between expected and actual experience in the measurement of total OPEB liability	408	2,038	219	<b>2,665</b>
Employer’s contributions to the Plan subsequent to the measurement of total OPEB liability	-	-	1,300	<b>1,300</b>
Total deferred outflows of resources	<b>\$ 1,195</b>	<b>\$ 3,057</b>	<b>\$ 1,678</b>	<b>\$ 5,930</b>

	January 31, 2017			
	Health	Life	Disability	Total
<u>Deferred outflows of resources</u>				
Differences between projected and actual earnings on OPEB assets	\$ 25,246	\$ 5,312	\$ 455	\$ 31,013
Employer’s contributions to the Plan subsequent to the measurement of total OPEB liability	8,500	-	700	9,200
Total deferred outflows of resources	<b>\$ 33,746</b>	<b>\$ 5,312</b>	<b>\$ 1,155</b>	<b>\$ 40,213</b>

The following table presents the future amortization of OPEB-related deferred outflows of resources and deferred inflows of resources, excluding the balance attributable to the employer's contribution to the Employee Benefit Plans in the current fiscal year and subsequent to the net OPEB (asset) liability measurement date. The deferred outflows of resources balance for such contribution amounts at the end of a fiscal period are recognized fully as adjustments to the net OPEB liability in the subsequent fiscal year.

**Amortization of OPEB-Related Deferred Outflows/Inflows of Resources**  
(In thousands)

Year ended January 31,	Health	Life	Disability	Total
2019	\$ 2,150	\$ 1,001	\$ 113	\$ 3,264
2020	2,150	1,001	113	3,264
2021	1,166	762	87	2,015
2022	(4,407)	(387)	(7)	(4,801)
2023	68	340	36	444
Thereafter	68	340	36	444
Total	<u>\$ 1,195</u>	<u>\$ 3,057</u>	<u>\$ 378</u>	<u>\$ 4,630</u>

## 11. Other Obligations and Risk Management

**Other Liabilities** – CPS Energy maintains other obligations as noted on the following tables. The relative long-term portion of these obligations compared to the total was 94.8% as of January 31, 2018, and 95.0% as of January 31, 2017.

**FY 2018 Other Liabilities Rollforward**  
(In thousands)

	Balance Outstanding 2-1-2017	Additions During Year	Decreases During Year	Balance Outstanding 1-31-2018	Amounts Due within One Year	Noncurrent Balance Outstanding
Decommissioning	\$ 439,386	\$ 29,944	\$ (5,827)	\$ 463,503	\$ 405	\$ 463,098
Decommissioning net costs refundable	107,317	52,011	(33,360)	125,968	-	125,968
	<u>546,703</u>	<u>81,955</u>	<u>(39,187)</u>	<u>589,471</u>	<u>405</u>	<u>589,066</u>
Other						
Customer deposits	40,936	23,946	(25,816)	39,066	23,309	15,757
Operating reserves	30,635	11,636	(10,751)	31,520	4,134	27,386
STP pension and OPEBs	88,850	15,001	(12,415)	91,436	-	91,436
Pollution remediation liability	3,369	1,819	(2,572)	2,616	881	1,735
Project Warm	7,742	150	(95)	7,797	-	7,797
Notes payable	2,496	8	(144)	2,360	136	2,224
Fuel hedges	8,188	19,824	(23,886)	4,126	390	3,736
Long-term service agreement liability	34,093	49,357	(17,508)	65,942	14,631	51,311
Other	14,998	21,164	(19,975)	16,187	130	16,057
Total other liabilities	<u>231,307</u>	<u>142,905</u>	<u>(113,162)</u>	<u>261,050</u>	<u>43,611</u>	<u>217,439</u>
Total other long-term liabilities	<u>\$ 778,010</u>	<u>\$ 224,860</u>	<u>\$(152,349)</u>	<u>\$ 850,521</u>	<u>\$ 44,016</u>	<u>\$ 806,505</u>

**FY 2017 Other Liabilities Rollforward**  
(In thousands)

	Balance Outstanding 2-1-2016	Additions During Year	Decreases During Year	Balance Outstanding 1-31-2017	Amounts Due within One Year	Noncurrent Balance Outstanding
Decommissioning	\$ 416,239	\$ 27,679	\$ (4,532)	\$ 439,386	\$ 1,484	\$ 437,902
Decommissioning net costs refundable	110,780	45,515	(48,978)	107,317	-	107,317
	<u>527,019</u>	<u>73,194</u>	<u>(53,510)</u>	<u>546,703</u>	<u>1,484</u>	<u>545,219</u>
Other						
Customer deposits	38,252	28,003	(25,319)	40,936	24,330	16,606
Operating reserves	26,330	12,891	(8,586)	30,635	3,710	26,925
STP pension and OPEBs	82,762	14,176	(8,088)	88,850	-	88,850
Pollution remediation liability	1,462	5,236	(3,329)	3,369	1,266	2,103
Project Warm	7,767	215	(240)	7,742	-	7,742
Notes payable	2,816	42	(362)	2,496	139	2,357
Fuel hedges	38,495	25,406	(55,713)	8,188	7,146	1,042
Long-term service agreement liability	-	41,033	(6,940)	34,093	950	33,143
Other	17,608	25,124	(27,734)	14,998	7	14,991
Total other liabilities	<u>215,492</u>	<u>152,126</u>	<u>(136,311)</u>	<u>231,307</u>	<u>37,548</u>	<u>193,759</u>
Total other long-term liabilities	<u>\$ 742,511</u>	<u>\$ 225,320</u>	<u>\$(189,821)</u>	<u>\$ 778,010</u>	<u>\$ 39,032</u>	<u>\$ 738,978</u>

**Long-Term Service Agreements (“LTSA”)** – CPS Energy has two LTSAs with General Electric, Inc. (“GE”) for two of its combined-cycle power plants, Arthur Von Rosenberg (“AVR”) and Rio Nogales.

*AVR* - In 2007, CPS Energy entered into a 20-year LTSA with GE to provide maintenance services and select replacement parts for the AVR power plant. In September 2015, the contract was amended primarily to add a provision for the advance purchase from GE of three new sets of Advanced Gas Path (“AGP”) parts to eventually be installed at the AVR plant.

In FY 2017, delivery was complete and title was transferred to CPS Energy for all three sets of AGP parts, at the purchase cost of \$18.7 million each. AGP parts not immediately required for maintenance procedures are recorded to inventory until the installation process for each set of parts at the power plant is initiated, at which time the costs are reclassified to capital assets. The liability for the purchase, along with other LTSA payment obligations, is recorded as a liability on the Statements of Net Position.

At January 31, 2017, two sets of the AGP parts had been transferred to capital assets. The third set was reported as noncurrent inventory, with installation earmarked for 2020. The balance of the LTSA obligation at January 31, 2017, totaled \$34.1 million of which \$1.0 million and \$33.1 million was reported as a current and noncurrent liability, respectively, on the Statements of Net Position.

In FY 2018, the purchase cost of all three sets of AVR AGP parts was adjusted to reflect a revised purchase price. The first two sets were recorded at \$19.7 million each and the third set was recorded at \$20.1 million. The balance of the AVR LTSA obligation at January 31, 2018, totaled \$34.9 million of which \$1.9 million and \$33.0 million was reported as a current and noncurrent liability, respectively.

*Rio Nogales* - In March 2017, the existing Rio Nogales power plant LTSA contract was amended primarily to add a provision for the advance purchase from GE of four new sets of AGP parts to eventually be installed at the power plant.

During FY 2018, delivery for the first set of AGP parts and a portion of the second set of parts was complete and title was transferred to CPS Energy. The first full set of AGP parts was recorded at \$19.0 million and the partial second set was recorded at \$13.1 million, both sets are reported as noncurrent inventory.

The balance of the Rio Nogales LTSA obligation at January 31, 2018, totaled \$31.0 million of which \$12.7 million and \$18.3 million was reported as a current and noncurrent liability, respectively, on the Statements of Net Position.

**Insurance and Reserves** – CPS Energy is exposed to various risks of loss including, but not limited to, those related to torts, theft or destruction of assets, errors and omissions, and natural disasters. CPS Energy maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major risks. The property insurance program provides \$3.5 billion of replacement-value coverage for property and boiler machinery loss, including comprehensive automobile coverage, and fire damage coverage for construction equipment and valuable papers. The deductible for the property insurance policy is \$1.0 million for non-power plant/non-substation locations, \$2.5 million for substations and \$5.0 million for power plant locations.

The liability insurance program includes:

- \$100 million of excess general liability coverage over a retention amount of \$3 million;
- \$25 million of fiduciary liability coverage;
- \$100 million of employment practices liability coverage; and
- Other property and liability insurance coverage, which includes directors & officers, commercial crime, employee travel and event insurance.

CPS Energy also manages its own workers' compensation program. To support this program, \$35 million of excess workers' compensation coverage over a retention amount of \$3 million is maintained. No claims exceeded insurance coverage and there were no decreases in coverage in FY 2018, FY 2017 or FY 2016.

Actuarial studies are performed periodically to assess the adequacy of CPS Energy insurance reserve retentions. Actuarial valuations include nonincremental claims expenses. An actuarial study was last completed in the fourth quarter of FY 2018.

In the following table, the remaining balance under the property reserve column at January 31, 2018, relates to estimated obligations for the cleanup, closure and post-closure care requirements of the Company's landfills. CPS Energy has seven landfill sites, four of which are at full capacity. The estimates for landfills, surface impoundment and ash ponds liability are based upon capacity to date and are subject to change due to inflation or deflation, as well as new developments in technology, applicable laws or regulations.

Under CPS Energy's reserve program, all claims are recorded against the reserve, which is a component of operating reserves presented on the preceding tables describing Other Liabilities.

#### **FY 2017 and FY 2018 Reserve Rollforward**

(In thousands)

	Employee & Public Liability Claims	Property Reserves	Total
Balance – FY 2016	\$ 18,477	\$ 6,150	\$ 24,627
Payments	(4,822)	-	(4,822)
Other claims adjustments	8,442	585	9,027
Balance – FY 2017	22,097	6,735	28,832
Payments	(5,869)	-	(5,869)
Other claims adjustments	4,589	1,873	6,462
Balance – FY 2018	<u>\$ 20,817</u>	<u>\$ 8,608</u>	<u>\$ 29,425</u>

**Counterparty Risk** – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, fuel hedging, suppliers and wholesale power. Counterparty risk is the risk that a counterparty will fail to meet its obligations in accordance with the terms and conditions of its contract with CPS Energy. CPS Energy has policies and practices in place to ensure the solvency of counterparties is assessed accurately, monitored regularly and managed actively through its Enterprise Risk Management & Solutions Division.

## 12. Other Financial Instruments

**Fuel Hedging** – The 1999 Texas utility deregulation legislation, Senate Bill 7, contains provisions modifying the PFIA to allow municipal utilities the ability to purchase and sell energy-related derivative instruments in order to hedge or mitigate the effect of market price fluctuations of natural gas, fuel oil and electric energy. In 2002, CPS Energy began hedging its exposure to changes in natural gas prices, with the goal of controlling fuel costs to native load customers and stabilizing the expected cash flows associated with wholesale power transactions.

CPS Energy reports its derivative instruments in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which addresses recognition, measurement and disclosures related to derivative instruments. CPS Energy does not use derivative instruments for speculative purposes. The only derivative instruments entered into are for the purposes of risk mitigation; therefore, these instruments are considered potential hedging derivative instruments under GASB Statement No. 53.

On December 11, 2017, the Board reaffirmed the Energy Price Risk Management Policy, which sets forth the guidelines for the purchase and sale of certain financial instruments and certain physical products, collectively defined as hedge instruments. The essential goal of the Energy Price Risk Management Policy is to provide a framework for the operation of a fuel and energy price hedging program to better manage CPS Energy's risk exposure in order to stabilize pricing and costs for the benefit of CPS Energy and its customers.

In accordance with the requirements of GASB Statement No. 53, all fuel hedges are reported on the Statements of Net Position at fair value. The fair value of option contracts is determined using New York Mercantile Exchange ("NYMEX") closing settlement prices as of the last day of the reporting period. For fixed-price contracts, the fair value is calculated by deriving the difference between the closing futures prices on the last day of the reporting period and the futures or basis swap purchase prices at the time the positions were established. See additional disclosures regarding fuel hedge fair values at Note 13 – Fair Value Measurement.

All hedging derivative instruments were evaluated for effectiveness at January 31, 2018 and 2017. The instruments were categorized into two broad groups for the purposes of this testing. In one category, hedges utilize natural gas forwards and options that are priced based on the underlying Henry Hub natural gas price, while the physical gas is typically purchased at prices based on either the Western Area Hub Association ("WAHA") or the Houston Ship Channel ("HSC"). Therefore, effectiveness testing was based on the extent of correlation between the first of the month index prices of natural gas at each of these locations and the settlement price at Henry Hub. The correlation coefficient was established by GASB Statement No. 53 as the critical term to be evaluated, with 0.8944 established as the minimum standard tolerated. The testing, based on two different location hubs (WAHA and HSC), demonstrated a substantial offset in the fair values, as evidenced by their calculated R values, 0.9639 and 0.9849, respectively, indicating that the changes in cash flows of the derivative instruments substantially offset the changes in cash flows of the hedgeable item. Additionally, the substantive characteristics of the hedge have been considered, and the evaluation of this effectiveness measure has been sufficiently completed.

and documented such that a different evaluator, using the same method and assumptions, would reach substantially similar results.

In the second category, hedges utilize both Henry Hub based natural gas forwards and locational basis swaps to the appropriate natural gas hub (WAHA or HSC) with volumes matching the underlying expected physical transaction. Considering the substantive characteristics of these hedge transactions, these instruments were tested for effectiveness utilizing the consistent critical terms method prescribed under GASB Statement No. 53.

In FY 2018, as a result of revisions to the expected volumes of some underlying wholesale physical transactions, it was determined that a group of existing financial hedge positions in this category were no longer effective. Offsetting financial positions were executed and the fair value of the ineffective hedges resulted in a loss totaling \$0.08 million, which was recognized as a reduction in investment income. All other hedging derivative instruments in both effectiveness testing categories were determined to be effective in substantially offsetting the changes in cash flows of the hedgeable items at January 31, 2018 and 2017.

As of January 31, 2018, the total fair value of outstanding hedge instruments was a net liability of \$1.9 million. Fuel hedging instruments with a fair value of \$0.6 million and \$ (0.4) million are classified on the Statements of Net Position as a component of current assets and current accounts payable and accrued liabilities, respectively. Long-term fuel hedging instruments with a fair value of \$1.6 million and \$(3.7) million are classified as a component of other noncurrent assets and other noncurrent liabilities, respectively.

As of January 31, 2017, the total fair value of outstanding hedge instruments was a net liability of \$6.3 million. Fuel hedging instruments with a fair value of \$0.8 million and \$ (7.1) million are classified on the Statements of Net Position as a component of current assets and current accounts payable and accrued liabilities respectively. Long-term fuel hedging instruments with a fair value of \$1.0 million and \$(1.0) million are classified as a component of other noncurrent assets and other noncurrent liabilities, respectively.

Consistent with hedge accounting treatment required for derivative instruments that are determined to be effective in offsetting changes in the cash flows of the hedged item, changes in fair value are reported as deferred outflows or deferred inflows of resources on the statements of net position until the contract expiration that occurs in conjunction with the hedged expected fuel purchase transaction. When fuel hedging contracts expire, at the time the purchase transactions occur, the deferred balance is recorded as an adjustment to fuel expense. The deferred outflows of resources related to fuel hedges totaled \$6.9 million at January 31, 2018, and \$7.8 million at January 31, 2017. The deferred inflows of resources related to fuel hedges totaled \$2.8 million at January 31, 2018.

Following is information related to CPS Energy's outstanding fuel hedging derivative instruments:

### Fuel Derivative Transactions as of January 31, 2018

(Dollars in thousands)

Type of Transaction	Referenced Index	Duration	Volumes (MMBtu)	Fair Value	FY 2018 Change in Fair Value
Long Natural Gas Swap	Henry Hub	Feb 2018 through Dec 2022	29,916,034	\$ (218)	\$ 5,234
Short Natural Gas Swap	Henry Hub	Feb 2018 through Dec 2022	3,793,245	(178)	23
Long Natural Gas Call Option	Henry Hub	Feb 2018 through Jan 2021	26,375,251	2,599	(3,811)
Short Natural Gas Call Option	Henry Hub	Nov 2018 through Jan 2020	23,218	(2)	5
Long Natural Gas Put Option	Henry Hub	Nov 2018 through Jan 2020	23,218	1	(3)
Short Natural Gas Put Option	Henry Hub	Feb 2018 through Jan 2021	26,320,251	(2,151)	1,981
Long HSC Basis Swap	Henry Hub	Feb 2018 through Dec 2022	23,269,064	(1,906)	144
Short HSC Basis Swap	Henry Hub	Mar 2018 through Dec 2022	1,545,681	58	(212)
Long HSC Gas Daily Swap	Henry Hub	Feb 2018 through Sep 2018	3,252,000	(27)	(22)
Long WAHA Basis Swap	Henry Hub	Apr 2018 through May 2018	1,525,000	(101)	(101)
Long WAHA Gas Daily Swap	Henry Hub	Feb 2018 through Feb 2018	350,000	(18)	(13)
				<u>\$ (1,943)</u>	<u>\$ 3,225</u>

### Fuel Derivative Transactions as of January 31, 2017

(Dollars in thousands)

Type of Transaction	Referenced Index	Duration	Volumes (MMBtu)	Fair Value	FY 2017 Change in Fair Value
Long Natural Gas Swap	Henry Hub	Feb 2017 through Dec 2019	28,141,485	\$ (5,452)	\$ 29,436
Short Natural Gas Swap	Henry Hub	Feb 2017 through Jun 2018	2,544,363	(201)	(2,455)
Long Natural Gas Call Option	Henry Hub	Feb 2017 through Jan 2020	15,846,573	3,844	775
Long Natural Gas Put Option	Henry Hub	Feb 2017 through Mar 2017	1,109,000	-	(180)
Short Natural Gas Put Option	Henry Hub	Feb 2017 through Jan 2020	13,925,700	(2,709)	850
Long HSC Basis Swap	Henry Hub	Feb 2017 through Dec 2019	20,010,344	(2,050)	(13)
Short HSC Basis Swap	Henry Hub	Feb 2017 through Jun 2018	1,924,363	270	51
Long HSC Gas Daily Swap	Henry Hub	Feb 2017 through Feb 2017	546,000	(5)	-
Long WAHA Gas Daily Swap	Henry Hub	Feb 2017 through Feb 2017	546,000	(5)	15
				<u>\$ (6,308)</u>	<u>\$ 28,479</u>

In the event purchased options are allowed to expire, the related premiums paid to acquire those options will be lost. When a short position is established and options are sold, premiums are received and an obligation to honor the terms of the option contract, if exercised, is created. The decision to exercise the options or let them expire rests with the purchasing party.

Futures contracts represent a firm obligation to buy or sell the underlying asset. If held to expiration, the contract holder must take delivery of, or deliver, the underlying asset at the established contract price. Basis swap contracts represent a financial obligation to buy or sell the underlying delivery point basis. If held to expiration, the financial difference determined by mark-to-market valuation must be settled on a cash basis. Only if expressly requested in advance may an exchange for physical assets take place.

**Credit Risk** – CPS Energy executes over-the-counter hedge transactions directly with approved counterparties. These counterparties are generally highly rated entities that are leaders in their respective industries. CPS Energy monitors the creditworthiness of these entities on a daily basis and manages the resulting financial exposure via a third-party, vertically integrated risk system. Contractual terms with each existing counterparty vary, but each is structured so that, should the counterparty's credit rating fall below investment grade, no unsecured credit would be granted and the counterparty would be required to post collateral for any calculated credit exposure. In the event of default or nonperformance by counterparties, brokers or NYMEX, the operations of CPS Energy could be materially affected. However, CPS Energy does not expect these entities to fail to meet their obligations given the level of their

credit ratings and the monitoring procedures in place with which to manage this risk. As of January 31, 2018, the exposure to all hedge-related counterparties was such that no material counterparty credit risk existed.

**Termination Risk** – For CPS Energy’s fuel hedges that are executed over the counter directly with approved counterparties, the possibility exists that one or more of these derivative instruments may end earlier than expected, thereby depriving CPS Energy of the protection from the underlying risk that was being hedged or potentially requiring CPS Energy to make a significant termination payment. This termination payment between CPS Energy and its counterparty is determined based on current market prices. In the event a transaction is terminated early, CPS Energy would likely be able to replace the transaction at current market prices with similar, although not exact, terms with one of its other approved counterparties.

**Basis Risk** – The Company is exposed to basis risk on its fuel hedges because the expected commodity purchases being hedged will price based on a pricing point (HSC or WAHA) different than which the contracts are expected to settle (Henry Hub). For January 2018, the HSC price was \$2.66 per MMBtu, the WAHA price was \$2.33 per MMBtu and the Henry Hub price was \$2.74 per MMBtu.

**Congestion Revenue Rights** – In the normal course of business, CPS Energy acquires Preassigned Congestion Revenue Rights (“PCRRs”) and Congestion Revenue Rights (“CRRs”) as a hedge against congestion costs. The CRRs are purchased at semi-annual and monthly auctions at market value. Non-Opt-In Entities are granted the right to purchase PCRRs annually at a percentage of the cost of CRRs. While PCRRs exhibit the three characteristics of derivatives as defined in GASB Statement No. 53, they are generally used by CPS Energy as factors in the cost of transmission. Therefore, these PCRRs meet the normal purchases and sales scope exception and are thus reported on the Statements of Net Position at cost and classified as prepayments. From time to time, the Company purchases PCRRs and sells them at the same auction at market price. In this case, the PCRRs are considered investments and the proceeds are reported as either investment gains or losses. There were no gains or losses on the sale of PCRRs and CRRs for FY 2018. Losses on the sale of PCRRs and CRRs totaled \$7.8 thousand for FY 2017.

### 13. Fair Value Measurement

CPS Energy records assets and liabilities in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, which determines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurement.

Fair value is defined in GASB Statement No. 72 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Fair value is a market-based measurement for a particular asset or liability based on assumptions that market participants would use in pricing the asset or liability. Such assumptions include observable and unobservable inputs of market data, as well as assumptions about risk and the risk inherent in the inputs to the valuation technique.

As a basis for considering market participant assumptions in fair value measurements, GASB Statement No. 72 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

- Level 1 inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date. Equity securities and U.S. Government Treasury securities are examples of Level 1 inputs.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Government agency and mortgage-backed securities are examples of Level 2 inputs.
- Level 3 inputs are unobservable inputs that reflect CPS Energy's own assumptions about factors that market participants would use in pricing the asset or liability (including assumptions about risk).

Valuation methods of the primary fair value measurements disclosed below are as follows:

- The majority of investments in equity securities are valued using Level 1 measurements. Investments in equity securities are typically valued at the closing price in the principal active market. For equity securities, these markets include published exchanges such as the National Association of Securities Dealers Automated Quotations and the New York Stock Exchange. Foreign equity prices are translated from their trading currency using the currency exchange rate in effect at the close of the principal active market.
- Most investments in debt securities are valued using Level 2 measurements because the valuations use interest rate curves and credit spreads applied to the terms of the debt instrument (maturity and coupon interest rate) and consider the counterparty credit rating.
- Commodity derivatives, such as futures, swaps and options, which are ultimately settled using prices at locations quoted through clearinghouses are valued using Level 1 inputs. Options included in this category are those with an identical strike price quoted through a clearinghouse.
- Other commodity derivatives, such as swaps settled using prices at locations other than those quoted through clearinghouses and options with strike prices not identically quoted through a clearinghouse, are valued using Level 2 inputs. For these instruments, fair value is based on internally developed pricing algorithms using observable market quotes for similar derivatives. Pricing inputs are derived from published exchange transactions and other observable data sources.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the valuation of fair value assets and liabilities and their place within the fair value hierarchy levels.

CPS Energy's fair value measurements are performed on a recurring basis. The table on the following page presents fair value balances and their levels within the fair value hierarchy as of January 31, 2018 and 2017. The CPS Energy and Decommissioning Trusts investment balances presented exclude amounts related to money market mutual fund investments and short-term investments accounted for using amortized cost.

## Fair Value Measurements as of January 31, 2018 and 2017

(In thousands)

	January 31, 2018				January 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
<b>Fair Value Investments</b>								
<b>CPS Energy</b>								
U.S. Treasuries	\$ 27,472	\$ -	\$ -	\$ 27,472	\$ 10,046	\$ -	\$ -	\$ 10,046
U.S. Agencies								
Federal Agricultural Mortgage Corp	-	24,813	-	24,813	-	-	-	-
Federal Farm Credit Bank	-	97,858	-	97,858	-	101,205	-	101,205
Federal Home Loan Bank	-	98,372	-	98,372	-	86,943	-	86,943
Federal Home Loan Mortgage Corp	-	105,793	-	105,793	-	126,866	-	126,866
Federal National Mortgage Assn	-	118,673	-	118,673	-	111,608	-	111,608
Small Business Administration	-	32,382	-	32,382	-	37,498	-	37,498
Municipal bonds	-	151,728	-	151,728	-	144,337	-	144,337
Total CPS Energy fair value investments	<u>27,472</u>	<u>629,619</u>	<u>-</u>	<u>657,091</u>	<u>10,046</u>	<u>608,457</u>	<u>-</u>	<u>618,503</u>
<b>Decommissioning Trusts Investments</b>								
<b>28% Trust</b>								
U.S. Treasuries	47,860	-	-	47,860	44,577	-	-	44,577
U.S. Agencies								
Federal Farm Credit Bank	-	5,656	-	5,656	-	5,398	-	5,398
Federal Home Loan Mortgage Corp	-	44,956	-	44,956	-	39,460	-	39,460
Federal National Mortgage Assn	-	32,435	-	32,435	-	36,553	-	36,553
Government National Mortgage Assn	-	2,699	-	2,699	-	3,323	-	3,323
Small Business Administration	-	3,995	-	3,995	-	3,785	-	3,785
Municipal bonds - Texas	-	1,228	-	1,228	-	872	-	872
Municipal bonds - other states	-	6,599	-	6,599	-	6,555	-	6,555
Corporate bonds	-	96,019	-	96,019	-	90,395	-	90,395
Foreign bonds	-	8,905	-	8,905	-	10,105	-	10,105
Total 28% Trust fair value fixed-income income portfolio	<u>47,860</u>	<u>202,492</u>	<u>-</u>	<u>250,352</u>	<u>44,577</u>	<u>196,446</u>	<u>-</u>	<u>241,023</u>
Equity securities								
Common stock	120,803	-	-	120,803	97,983	-	-	97,983
Real estate investment trusts	40,416	-	-	40,416	38,263	-	-	38,263
Preferred stock	-	742	-	742	-	697	-	697
Total 28% Trust fair value investments	<u>209,079</u>	<u>203,234</u>	<u>-</u>	<u>412,313</u>	<u>180,823</u>	<u>197,143</u>	<u>-</u>	<u>377,966</u>
<b>12% Trust</b>								
U.S. Treasuries	15,563	-	-	15,563	14,500	-	-	14,500
U.S. Agencies								
Federal Farm Credit Bank	-	4,388	-	4,388	-	2,477	-	2,477
Federal Home Loan Mortgage Corp	-	14,726	-	14,726	-	13,659	-	13,659
Federal National Mortgage Assn	-	10,315	-	10,315	-	11,968	-	11,968
Government National Mortgage Assn	-	1,284	-	1,284	-	1,582	-	1,582
Small Business Administration	-	1,587	-	1,587	-	1,343	-	1,343
Municipal bonds - Texas	-	502	-	502	-	416	-	416
Municipal bonds - other states	-	2,000	-	2,000	-	1,857	-	1,857
Corporate bonds	-	34,073	-	34,073	-	33,003	-	33,003
Foreign bonds	-	2,052	-	2,052	-	2,416	-	2,416
Total 12% Trust fair value fixed-income income portfolio	<u>15,563</u>	<u>70,927</u>	<u>-</u>	<u>86,490</u>	<u>14,500</u>	<u>68,721</u>	<u>-</u>	<u>83,221</u>
Equity securities								
Common stock	48,334	-	-	48,334	38,782	-	-	38,782
Real estate investment trusts	14,439	-	-	14,439	13,632	-	-	13,632
Total 12% Trust fair value investments	<u>78,336</u>	<u>70,927</u>	<u>-</u>	<u>149,263</u>	<u>66,914</u>	<u>68,721</u>	<u>-</u>	<u>135,635</u>
Total Trusts fair value investments	<u>287,415</u>	<u>274,161</u>	<u>-</u>	<u>561,576</u>	<u>247,737</u>	<u>265,864</u>	<u>-</u>	<u>513,601</u>
Total fair value investments	<u>\$ 314,887</u>	<u>\$ 903,780</u>	<u>\$ -</u>	<u>\$ 1,218,667</u>	<u>\$ 257,783</u>	<u>\$ 874,321</u>	<u>\$ -</u>	<u>\$ 1,132,104</u>
<b>Financial Instruments</b>								
<b>Assets</b>								
Current fuel hedges	\$ 110	\$ 120	\$ -	\$ 230	\$ -	\$ -	\$ -	\$ -
Noncurrent fuel hedges	(62)	199	-	137	(753)	756	-	3
Total financial instruments - Assets	<u>\$ 48</u>	<u>\$ 319</u>	<u>\$ -</u>	<u>\$ 367</u>	<u>\$ (753)</u>	<u>\$ 756</u>	<u>\$ -</u>	<u>\$ 3</u>
<b>Liabilities</b>								
<b>Financial Instruments</b>								
Current fuel hedges	\$ (2)	\$ -	\$ -	\$ (2)	\$ (6,603)	\$ 292	\$ -	\$ (6,311)
Noncurrent fuel hedges	(2,376)	68	-	(2,308)	-	-	-	-
Total financial instruments - (Liabilities)	<u>\$ (2,378)</u>	<u>\$ 68</u>	<u>\$ -</u>	<u>\$ (2,310)</u>	<u>\$ (6,603)</u>	<u>\$ 292</u>	<u>\$ -</u>	<u>\$ (6,311)</u>
Total financial instruments	<u>\$ (2,330)</u>	<u>\$ 387</u>	<u>\$ -</u>	<u>\$ (1,943)</u>	<u>\$ (7,356)</u>	<u>\$ 1,048</u>	<u>\$ -</u>	<u>\$ (6,308)</u>

## 14. South Texas Project

**Units 1 and 2** – CPS Energy is one of three participants in STP, currently a two-unit nuclear power plant with each unit having a nominal output of approximately 1,330 MW. The other participants in STP Units 1 and 2 are NRG South Texas LLP (“NRG”), a wholly owned subsidiary of NRG Energy, Inc., and the City of Austin. The units, along with their support facilities and administrative offices, are located on a 12,220-acre site in Matagorda County, Texas. In-service dates for STP were August 1988 for Unit 1 and June 1989 for Unit 2. CPS Energy’s 40% ownership in STP Units 1 and 2 represents approximately 1,064 MW of total plant capacity.

Effective November 17, 1997, the Participation Agreement among the owners of STP was amended and restated. At that time, STPNOC, a Texas nonprofit, nonmember corporation created by the participants, assumed responsibility as the licensed operator of STP. The participants share costs in proportion to ownership interests, including all liabilities and expenses of STPNOC. STPNOC is financed and controlled by the owners pursuant to an operating agreement among the owners and STPNOC. Currently, a four-member board of directors governs STPNOC, with each owner appointing one member to serve with STPNOC’s chief executive officer.

**STP Units 1 and 2 Licenses Renewed** – On October 28, 2010, STP submitted license renewal applications to the NRC to extend the operating licenses of STP Units 1 and 2 to 2047 and 2048, respectively. The NRC issued a letter on February 10, 2017, which provided an Updated Safety Review Schedule for the STP Units 1 and 2 license applications and indicated the scheduled date for issuance of the Safety Evaluation Report (“SER”) as June 2017, followed by a full Advisory Committee on Reactor Safeguards (“ACRS”) meeting on the SER in July 2017. The issuance of the SER and the full ACRS meeting were both completed as scheduled. In September 2017, the NRC approved STPNOC’s license renewal applications for STP Units 1 and 2, which extends the operating licenses to 2047 and 2048, respectively.

**Suspension of Used Nuclear Fuel Fee** – Under the Nuclear Waste Policy Act (“NWPA”), the DOE has an obligation to provide for the permanent disposal of high-level radioactive waste, which includes used nuclear fuel at U.S. commercial nuclear power plants such as STP. To fund that obligation, all owners or operators of commercial nuclear power plants entered into a standard contract under which the owners paid a fee to the DOE based on the amount of electricity generated and sold from the power plant, along with additional assessments. In exchange for collecting this fee and the assessments, the DOE undertook the obligation to develop a high-level waste repository for safe, long-term storage of the fuel and, no later than January 31, 1998, to transport and dispose of the used fuel. To date, no high-level waste repository has been licensed to accept used fuel. NARUC challenged further collection of this fee; and on November 19, 2013, the Court ruled in favor of NARUC and ordered the DOE to submit to the U.S. Congress a proposal to reduce the fee to zero until certain conditions are met. While the reporting to the DOE of used nuclear fuel volumes will continue, effective May 16, 2014, the rate was reduced to zero.

**DOE Settlement and Dry Cask Storage Project** – Multiple cases have been filed in the U.S. Court of Federal Claims by the existing owners or operators of nuclear facilities against the DOE related to its failure to meet its obligations under the NWPA. The owners/operators were seeking damages related to ongoing used nuclear fuel storage costs incurred because the DOE did not meet its obligation. On August 31, 2000, in *Maine Yankee Atomic Power Company, et. al. v. United States*, the U.S. Court of Appeals for the Federal Circuit affirmed that the DOE had breached its obligations to commercial nuclear power plant owners for failing to live up to its obligations to dispose of used nuclear fuel. Subsequent to that decision, the DOE settled with certain commercial nuclear power plant owners and agreed to provide funds to pay for storage costs while the DOE continues to develop a permanent high-level waste repository.

In February 2013, STPNOC, on behalf of the owners of STP, entered into a similar settlement with the DOE. Under the terms of the settlement, the DOE reimbursed STP for certain costs incurred in continuing onsite storage of all of its used nuclear fuel through December 2013. A settlement extension, executed on January 24, 2014, extended the term of the Spent Fuel Settlement Agreement with the DOE through December 31, 2016. In the most recent settlement agreement dated March 15, 2017, the DOE extended its commitment to reimburse STP for allowable spent fuel management expenditures through December 31, 2019. Pursuant to STPNOC's analysis of NRC guidance, STPNOC has started the process of planning, licensing, and building an on-site independent spent fuel storage installation ("ISFSI" or the "Dry Cask Storage Project") with an expectation that the ISFSI will be operational in 2019.

Ongoing costs for the spent fuel management project are being funded by the STP owners as expenditures are incurred. CPS Energy requests reimbursement periodically from its Decommissioning Trusts for the Company's portion of allowable costs. Annually, STPNOC submits claims to the DOE for the reimbursement of allowable costs for spent fuel management. Allowable costs are returned by STP to the owners upon receipt of funds from the DOE. In turn, the settlement amount received from the DOE by CPS Energy is reimbursable to the Trusts. Qualifying spent fuel management costs not reimbursable by the DOE are funded by the Trusts. Any costs not reimbursable by the DOE or the Trusts are recorded as an STP O&M expense or capital costs.

**Post-Fukushima Recommendations** – On March 11, 2011, a region of Japan sustained significant loss of life and destruction as a result of a major earthquake and resulting tsunami. Included in the damaged areas were the Fukushima Daiichi nuclear units, which lost power to components of the backup and safety control systems and began emitting radiation into the surrounding environment. Following the incident, the NRC convened a Near-Term Task Force to conduct a review of the Commission's processes and regulations in light of the events at Fukushima. The Near-Term Task Force's 90-day report confirmed the safety of U.S. nuclear power plants and included twelve recommendations to the NRC to enhance readiness to safely manage severe events. The NRC Commissioners directed the staff to implement several of the recommendations that were identified as those that should be implemented without unnecessary delay. In addition, the Commissioners directed the staff to identify the schedule and resource needs associated with those Near-Term Task Force recommendations that were identified as long-term actions and/or that require additional staff study to inform potential regulatory changes. On March 12, 2012, the NRC issued three Orders and one Request for Information letter. These actions represented the first regulatory activity initiated as a result of the lessons learned from the events at Fukushima. The Orders outlined actions that must be taken and also provided a compliance deadline. License holders were to complete the actions within two refueling outages or by December 31, 2016, whichever came first. To date, STPNOC has submitted the requested information and complied with the NRC Orders in a timely manner on all deadlines that have come due.

**STP Unit 1 Control Rod D6 Issue** – On November 18, 2015, STP Unit 1 Shutdown Bank Control Rod D6 was determined to be inoperable following a scheduled refueling and maintenance outage. STP Unit 1 operated with 56 full-length control rods instead of 57 based on an Emergency License Amendment Request that was approved by the NRC on December 11, 2015. In December 2016, STP received notification from the NRC that Unit 1 Control Rod D6 License Amendment Request ("LAR") had been approved. The approved LAR permanently changes the Unit 1 Technical Specifications to reflect future operations without Shutdown Bank Control Rod D6. The approved changes were implemented during the spring 2017 Unit 1 refueling outage.

**NRC Violations** – On February 9, 2017, STPNOC received a final significance determination notice from the NRC that concluded a previously identified security-related finding was Greater than Green and of low to moderate significance. The finding was identified during an NRC inspection conducted from October 19 through December 1, 2016. STPNOC took prompt action to address the finding. Beginning February 16, 2017, the NRC webpage reflected STP Units 1 and 2 in the Regulatory Response column of

the Reactor Oversight Process (“ROP”) Action Matrix. In August 2017, STP successfully completed an NRC Inspection (95001) and in September 2017, the NRC determined that the actions taken by STPNOC were effective in identifying and correcting the cause and returned STP to the Licensee Response column of the NRC ROP effective October 2017.

On June 24, 2017, STPNOC informed the Owners that they had received NRC notification regarding two proposed apparent violations related to an Office of Investigation (“OI”) review into its Fire Watch Program. The two proposed violations were both based on results of the OI investigation into apparent willful violations involving the Fire Marshall during the 2014 – 2015 timeframe. Both violations are related to the falsification of Fire Watch records, whereby the Fire Marshall failed to provide complete and accurate information. Following an internal STP investigation into the Fire Watch Program in 2015, the Fire Marshall was terminated.

The NRC assessed these issues under the Traditional Enforcement program and recommended Severity Level 3 for these apparent violations because they involved supervisory personnel. For reference, Severity Level 4 violations are the lowest level of significance, with Severity Level 1 infractions being the most severe.

On June 29, 2017, STPNOC received a letter from the NRC that includes options of response. In response, STP documented in its corrective action program the reasons for the violations and the actions taken to address the issue. The NRC has noted that STP has already taken significant actions to address the Fire Marshall issue.

In late August 2017, the NRC upheld their recommendation and assigned Severity Level 3 to the violations under the Traditional Enforcement program. The NRC noted to STPNOC that civil penalty could have been assessed for these violations but the NRC considered STP’s significant actions to address the issues and terminate the employment of the Fire Marshall. The NRC assigned credit for these actions and the violations were closed with no further action.

**Texas Commission on Environmental Quality (“TCEQ”) Violations** - On January 11, 2018, STPNOC received a draft notice of enforcement letter from the TCEQ for three violations which all occurred in 2016. The violations were identified and reported by STPNOC to TCEQ and are related to STP’s air quality permit. These deviations were included in STP’s 2017 semi-annual report submitted to the TCEQ in February 2017.

On February 15, 2018, the TCEQ transmitted a proposed agreed order assessing a nominal administrative penalty regarding the Notice of Enforcement issued on January 11, 2018, for late reporting of the air quality permit deviation in 2016. The order acknowledges that STP submitted the report in February 2017 and did not require any additional corrective action. Once agreement is reached with the TCEQ, a notice of the proposed order will be published in the Texas Register and the matter will be scheduled for TCEQ Commissioners approval.

**Units 3 and 4 Development** – In September 2007, NRG and CPS Energy signed the South Texas Project Supplemental Agreement (“Supplemental Agreement”) under which CPS Energy elected to participate in the development of two new nuclear units at the STP site, STP Units 3 and 4, pursuant to the terms of the participation agreement among the STP owners and agreed to potentially own up to 50% of STP Units 3 and 4. Also in September 2007, STPNOC, on behalf of CPS Energy and NRG, filed with the NRC a combined construction and operating license application (“COLA”) to build and operate STP Units 3 and 4. This COLA was the first complete application for new commercial nuclear units to be filed with the NRC in nearly 30 years. On November 29, 2007, the NRC announced it had accepted the COLA for review.

On March 26, 2008, NRG announced the formation of NINA. Upon the formation of NINA, NRG had an 88.0% ownership interest in NINA, while Toshiba America Nuclear Energy Corporation (“TANE”) owned the remaining 12.0%. NRG contributed its 50% ownership of, and its development rights to, STP Units 3 and 4 to NINA. As a result, NINA became CPS Energy’s partner for the co-development of STP Units 3 and 4.

On September 24, 2008, STPNOC, on behalf of CPS Energy and NINA, filed with the NRC an updated COLA naming TANE as the provider of STP Units 3 and 4. Receipt of the NRC-approved combined operating license was a condition precedent to starting significant project construction.

In June 2009, CPS Energy management provided the Board its formal assessment and recommendations concerning these options compared to other possible new generation types including the first public estimate of the cost of the first possible project at \$13 billion, inclusive of financing costs. Reports of higher cost estimates, however, resulted in reconsideration of the advisability of participating in the STP Units 3 and 4 Project and, ultimately, in CPS Energy’s decision to limit participation in further development of STP Units 3 and 4. In a settlement negotiated with NRG and the other participants in the development of STP Units 3 and 4, CPS Energy received a 7.625% ownership interest in STP Units 3 and 4. CPS Energy is not liable for any STP Units 3 and 4 project development costs incurred after January 31, 2010, however, once the new units reach commercial operation, CPS Energy will be responsible for its 7.625% share of ongoing costs to operate and to maintain the units. Upon the DOE issuing a conditional loan guarantee to NINA, CPS Energy would receive two \$40 million installment payments. NINA agreed to and made a contribution of \$10.0 million over a four-year period to the Residential Energy Assistance Partnership, which provides emergency bill payment assistance to low-income customers in the City and Bexar County.

In August 2015, Toshiba Corporation (“Toshiba”) announced that it planned to write down its semiconductor, home appliance, and nuclear business units following an investigation into accounting issues that have resulted in the need for Toshiba to restate their past financial results. In its fiscal year ended March 31, 2017, Toshiba recorded a loss and wrote down the value of its Westinghouse nuclear power subsidiary, worth \$6.3 billion. Previously in 2011, NRG announced it had written off its investment in STP Units 3 and 4. On October 1, 2015, the NRC issued a press release indicating that NRC staff had completed its Final Safety Evaluation Report for the Combined Licenses (“COL”) for the proposed STP Units 3 and 4. The NRC staff provided the Final Safety Evaluation Report along with the Final Environmental Impact Statement on the application to the NRC for the mandatory hearing phase of the licensing process on November 19, 2015. On February 9, 2016, the NRC commissioners authorized issuance of the COL for STP Units 3 and 4 and the licenses were issued on February 12, 2016.

Despite the project having secured the NRC’s authorization for issuance of the COL, in January 2016 the Company concluded that as a result of sustained changes in a number of environmental and economic factors directly affecting the projected economic feasibility of completing construction of STP Units 3 and 4, the project had experienced a permanent impairment. The Company determined it was appropriate to write off the entire \$391.4 million investment in STP Units 3 and 4. The impairment loss was reported as an extraordinary item on CPS Energy’s Statements of Revenues, Expenses, and Changes in Net Position for the period ending January 31, 2016. This noncash transaction did not impact CPS Energy’s debt service coverage ratio; however, there was a resulting increase from 61.1% to 63.7% in the debt to debt and net position ratio at January 31, 2016. The Company continues to retain a legal interest in STP Units 3 and 4.

See Note 4 – Capital Assets, Net for more information about CPS Energy’s capital investment in STP.

**Nuclear Insurance** – STP maintains required insurance coverage pursuant to the Price-Anderson Act, providing limitations on liability and governmental indemnities with respect to nuclear incidents.

Pursuant to the Price-Anderson Act, effective January 1, 2017, the maximum amount that each licensee may be assessed following a nuclear incident at any insured facility is \$127 million, taking into account a 5% adjustment for administrative fees and subject to adjustment for inflation every 5 years, for the number of operating nuclear units and for each licensed reactor, payable at \$19 million per year per reactor for each nuclear incident. CPS Energy and each of the other participants of STP are subject to such assessments, which will be borne on the basis of their respective ownership interests. For purposes of these assessments, STP currently 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 nuclear liability policy, with a maximum limit of \$450 million for the nuclear industry as a whole, provides protection from nuclear-related claims. A Master Worker Certificate policy, also with a maximum limit of \$450 million for the nuclear industry as a whole, provides protection from radiation tort claims of workers at nuclear facilities.

NRC regulations require licensees of nuclear power plants to obtain on-site property damage insurance in a minimum amount of approximately \$1.1 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 Units 1 and 2 currently maintain nuclear property insurance at or above the legally required amount. The nuclear property insurance consists of primary property damage insurance and excess property damage insurance, both subject to a retrospective assessment being paid by all members of Nuclear Electric Insurance Limited ("NEIL"). A retrospective assessment could occur if property losses, as a result of an accident at any nuclear plant insured by NEIL, exceed the accumulated funds available to NEIL. CPS Energy also maintains accidental outage insurance through STP's NEIL membership that provides weekly indemnity payments for an insured property loss subject to an applied deductible period.

**Nuclear Decommissioning** – In 1991, CPS Energy started accumulating funds for decommissioning of its 28% ownership in STP Units 1 and 2 in an external trust in accordance with NRC regulations. The 28% Decommissioning Trust's assets and related liabilities are included in CPS Energy's financial statements as a component unit. Excess or deficient funds related to the 28% Trust will be distributed to or received from CPS Energy's ratepayers after decommissioning is complete.

In conjunction with the acquisition of the additional 12% interest in STP Units 1 and 2 in May 2005, the Company also assumed control of a relative portion of the decommissioning trust previously established by the prior owner, American Electric Power ("AEP"). The 12% Decommissioning Trust's assets and related liabilities are also included in CPS Energy's financial statements as a component unit. Subject to PUCT approval as may be requested in the future, excess or deficient funds related to the 12% Trust will be distributed to or received from AEP's ratepayers after decommissioning is complete.

CPS Energy, together with the other owners of STP Units 1 and 2, files a certificate of financial assurance with the NRC for the decommissioning of the nuclear power plant every two years or upon transfer of ownership. The certificate assures that CPS Energy and the other owners meet the minimum decommissioning funding requirements mandated by the NRC. The owners agreed in the financial assurance plan that their estimate of decommissioning costs would be reviewed and updated periodically. The most recent cost study, which was finalized in May 2013, estimated decommissioning costs for the 28% ownership in STP Units 1 and 2 at \$627.5 million in 2012 dollars. Included in the cost study was a 10% contingency component as required to comply with the PUCT. Based on the level of funds accumulated in the 28% Trust and an analysis of this cost study, the Company determined that no further decommissioning contributions will be required to be deposited into the Trust.

In FY 2009, CPS Energy determined that some preshutdown decommissioning and spent fuel management activities would be required prior to shutdown of STP Units 1 and 2. As a result, separate trust accounts were created to pay for preshutdown decommissioning activities. Additionally, funds in the Trusts applicable to spent fuel management were transferred to separate spent fuel management accounts so that they were not commingled with funds allocable to preshutdown or postshutdown decommissioning costs. Based on projected costs, the spent fuel management accounts are currently fully funded; therefore, no contributions were made to these accounts in FY 2018 or FY 2017. In FY 2018, no contributions were made to fund preshutdown decommissioning costs for CPS Energy's 28% ownership in STP. In FY 2017, contributions to fund preshutdown costs amounted to \$0.9 million. No preshutdown decommissioning expenses were incurred for the 28% ownership in calendar years 2017 or 2016. For the 12% Trust, preshutdown costs were funded by AEP's ratepayers. The 12% Trust incurred no preshutdown decommissioning expenses in the calendar years 2017 or 2016.

As of December 31, 2017 and 2016, CPS Energy had accumulated \$431.9 million and \$400.5 million, respectively, in the 28% Trust. Total funds are allocated to decommissioning costs, preshutdown decommissioning costs, spent fuel management and site restoration. Based on the most recent annual calculation of financial assurance required by the NRC as of December 31, 2016, the 28% Trust funds allocated to decommissioning costs totaled \$249.0 million, which exceeded the calculated financial assurance amount of \$152.5 million.

The May 2013 cost study estimated decommissioning costs for the 12% ownership in STP Units 1 and 2 at \$268.9 million in 2012 dollars. As of December 31, 2017 and 2016, \$157.5 million and \$145.1 million, respectively, had been accumulated in the 12% Trust. Total funds are allocated to decommissioning costs, preshutdown decommissioning costs, spent fuel management and site restoration. Based on the most recent annual calculation of financial assurance required by the NRC as of December 31, 2016, the 12% Trust funds allocated to decommissioning costs totaled \$97.2 million, which exceeded the calculated financial assurance amount of \$65.3 million.

The Company accounts for decommissioning by recognizing a liability and expense for a pro rata share of projected decommissioning costs as determined by the most recent finalized cost study. A new cost study is performed every five years; and, in years subsequent to the latest study, estimated annual decommissioning expense and an increase in the liability is calculated by applying the effects of inflation and the ratio of years of plant usage to total plant life. Additionally, a zero net position approach is applied in accounting for the Decommissioning Trusts. The total decommissioning liability and related annual decommissioning expense is calculated assuming the longer total plant life due to the license extensions.

Both Decommissioning Trusts also have separate calendar-year financial statements, which are separately audited and can be obtained by contacting the Controller at CPS Energy.

**STP Pension Plans and Other Post-retirement Benefits** – STPNOC maintains several pension and other post-retirement benefit plans covering most employees, including a noncontributory defined-benefit pension plan, defined-benefit post-retirement plan, supplementary nonqualified unfunded pension plan, supplemental retirement plan, deferred compensation program and a contributory savings plan. The owners of STPNOC, including CPS Energy, although not sponsors to the STP plans, share in all plan costs in the same proportion as their respective ownership percentages.

The noncontributory defined-benefit pension plan covers certain employees. Effective January 1, 2007, STPNOC approved a change to the pension plan to preclude the eligibility of employees hired after December 31, 2006, in the plan. Employees hired after this date receive enhanced matching contributions under the STP Nuclear Operating Company Savings Plan.

STPNOC also maintains a defined-benefit postretirement plan that provides postretirement health and welfare benefits. As of May 1, 2014, certain STPNOC employees voted to transition STPNOC's medical plan to a Taft-Hartley multi-employer health and welfare plan. STPNOC pays monthly premiums for the benefits, to be partially funded by participating employees.

Employees whose eligible compensation exceeds the limitations established under the 1974 Employee Retirement Income Security Act, \$270 thousand and \$265 thousand for 2017 and 2016, respectively, are covered by a supplementary nonqualified, unfunded pension plan, which is provided for by charges to operations sufficient to meet the projected benefit obligations. The accruals for the costs of that plan are based on substantially the same actuarial methods and economics as the noncontributory defined-benefit pension plan.

An unfunded supplemental retirement plan and other unfunded deferred compensation programs are maintained by STPNOC for certain key individuals.

The effect to CPS Energy of funding obligations related to the defined-benefit plans sponsored by STPNOC was \$10.6 million for FY 2018 and was reflected as a decrease in Other Changes in Net Position on the Statements of Revenues, Expenses and Changes in Net Position. For FY 2017, the effect of the defined benefit obligations was \$9.3 million and was reflected as a decrease in Other Changes in Net Position on the Statements of Revenues, Expenses and Changes in Net Position.

## **15. Commitments and Contingencies**

Purchase and construction commitments approximated \$6,870.0 million at January 31, 2018. This amount includes construction commitments, provisions for coal purchases through December 2021, coal transportation through December 2018, and natural gas purchases through June 2027; the actual amount to be paid will depend upon CPS Energy's actual requirements during the contract period and the price of gas. Also included are provisions for wind power through 2038, solar power through 2043, landfill power through 2029, and raw uranium associated with STP fabrication and conversion services needed for refueling through May 2026.

On January 20, 2009, the Board approved a policy statement affirming that CPS Energy's strategic direction centers on transforming from a company focused on providing low-cost power from traditional generation sources to a company providing competitively priced power from a variety of sources, including low and non-carbon emitting sources. To be sustainable, CPS Energy has to balance its financial viability, environmental commitments and social responsibility as a community-owned provider.

In FY 2008, CPS Energy entered into a Natural Gas Supply Agreement with the SA Energy Acquisition Public Facility Corporation ("PFC"), a component unit of the City, to purchase, to the extent of its gas utility requirements, all natural gas to be delivered under a Prepaid Natural Gas Sales Agreement. Under the Prepaid Natural Gas Sales Agreement between the PFC and a third-party gas supplier, the PFC prepaid the cost of a specified supply of natural gas to be delivered over 20 years. On February 25, 2013, the PFC executed certain amendments to the Prepaid Natural Gas Sales Agreement entered into with J. Aron in 2007 and other related documents with respect to the 2007 prepayment transaction with J. Aron. Under the resolution and the amendments, Goldman, Sachs & Co. surrendered for cancellation \$111.1 million of the SA Energy Acquisition Public Facility Corporation Gas Supply Revenue Bonds, Series 2007 owned by J. Aron; Goldman, Sachs & Co.; or affiliates. In exchange, the PFC agreed to reduce future required natural gas delivery volumes from 104.6 million MMBtu to 81.3 million MMBtu and to adjust the notional amount of its commodities price hedge so that hedged revenue from gas sales will bear at least the same proportion to annual debt service requirements as before the transaction. In conjunction with the transaction, a portion of the savings related to the purchase of natural gas from the PFC that would have

been passed on to CPS Energy's distribution gas customers over the 20-year life of the original agreement was accelerated. Distribution gas customers benefitted from the accelerated savings from March 1, 2013, through June 30, 2015. CPS Energy's 20-year commitment under the Natural Gas Supply Agreement is included in the aforementioned purchase and construction commitments amount.

On June 30, 2016, as a result of a Novation Agreement by and among The Bank of New York Mellon Trust Company, N. A. (formerly known as The Bank of New York Trust Company, N. A.), as trustee ("Trustee"), the PFC, Depfa Bank plc ("Transferor") and J. Aron & Company ("Transferee"), the Transferee assumed all of the Transferor's rights, title and interest in and to the Investment Agreement and all the duties, obligations and liabilities under the Investment Agreement (excluding any rights, obligations or liabilities of the Trustee or the Transferor prior to the Novation Effective Date). In addition, an Amended and Restated Investment Agreement was entered into to amend and restate the terms of the Investment Agreement. Consequently, a Second Supplemental Indenture to the Trust Indenture, by and between the PFC and the Trustee, was executed. The original Investment Agreement dated June 21, 2007, was replaced by the Amended and Restated Investment Agreement. The amendments contain provisions in the event of a downgrade in the credit rating on the guaranteed investment contract ("GIC") provider. If the higher rating between J. Aron and its guarantor, Goldman, Sachs & Co., falls below "BB+" by S&P, or "Ba1" by Moody's, which results in a ratings event, J. Aron is required to provide collateral equal to 100% of the invested balance held by J. Aron plus any accrued interest.

In FY 2003, CPS Energy entered into a 20-year agreement with Brooks Development Authority ("BDA") to upgrade the electric and gas utility systems located within Brooks City-Base. CPS Energy and BDA each committed to invest \$6.3 million (\$4.2 million in year 2002 dollars, which accumulates interest at the rate of 3.7% compounded annually) to upgrade the infrastructure at that location. Annual reductions to BDA's obligation were made from incremental revenues to the City for electric and gas sales to customers that reside on the BDA-developed property. Annual reductions to BDA's obligation were also made in accordance with contract terms for economic development at Brooks City-Base that benefitted CPS Energy's Systems. To date, capital renewals and upgrades of \$14.1 million have surpassed the \$12.6 million commitment. BDA has met its obligation, net of annual interest, of \$4.2 million.

In September 2010, CPS Energy and the University of Texas at San Antonio ("UTSA") entered into an agreement ("Strategic Alliance") whereby UTSA agreed to perform services for CPS Energy in support of its function as a provider of electric and gas utility services while supporting the progress of the City of San Antonio in renewable energy technologies and energy research. The Strategic Alliance calls for CPS Energy to invest up to but not exceeding \$50 million over 10 years. The investment made through January 31, 2018, was approximately \$8.7 million from funds currently allocated to research and development. Future funding will be determined by the scope of the projects defined by the partnership and is subject to annual approval by the CPS Energy Board of Trustees. Projects will be designed to produce clear value to CPS Energy and its customers.

CPS Energy sells excess power into the wholesale market with a balanced portfolio that includes a mix of short-term and mid-term transactions with market participants and long-term wholesale power agreements with other public power entities. In addition to long-standing wholesale power relationships with the cities of Castroville, Floresville and Hondo, the Company currently has agreements to provide either full or partial requirements to five additional public power entities. These agreements have varying terms expiring between 2018 and 2025. The volumes committed under these agreements represent approximately 5% to 7% of current capacity. The Company regularly monitors the market values of these transactions to manage contract provisions with the counterparties.

On June 20, 2011, CPS Energy announced its New Energy Economy initiative. The program is designed to focus on more clean energy sources rather than traditional energy sources and includes several major

initiatives to which the Company has committed (current commitments are included in the aforementioned \$6,870.0 million):

- CPS Energy offers customers the opportunity to better manage their home's energy use through the My Thermostat Rewards program. The program gives customers access to a wide choice of programmable thermostat options. Customers benefit from better control of their home's air conditioning use and the visibility to program settings from their mobile devices. Customers in My Thermostat Rewards can choose to have a CPS Energy's contractor install a free programmable thermostat in their place of residence. Alternatively, they can purchase and self-install their own thermostat from a list of qualifying devices and receive a rebate from CPS Energy. In exchange for the rebate, customers allow CPS Energy to periodically control and interrupt service to manage peak energy periods. The program is funded through STEP. As of January 31, 2018, there were 139,621 CPS Energy customers enrolled in My Thermostat Rewards.
- The Company is in the process of replacing 25,000 San Antonio streetlights with 250 Watt equivalent LED streetlights. The lights were purchased from GreenStar, a worldwide supplier of LED lighting. The streetlights use 60% less energy than standard sodium lights and are designed to last 12 to 15 years, thereby reducing maintenance costs. Approximately \$2.2 million of the deployment costs were funded through STEP, with the remainder being funded by the City. Through January 31, 2018, approximately 23,500 LED streetlights have been installed. The installation of the remaining 1,500 is currently on hold pending feedback from the City on lighting for the downtown area.

The City also requested the replacement of 30,000 residential streetlights with 100 Watt equivalent LED streetlights. The Company began this project in City Districts 2 and 5 where a total of 5,100 replacement LED lights were installed in FY 2017. A total of 4,275 were installed in FY 2018.

LED street lights have become the standard for ongoing city-wide streetlight maintenance. As older sodium lights fail, they will be replaced with GreenStar LED equivalents.

- In November 2011, the Company entered into a \$77.0 million prepaid agreement with SunEdison for purchased power equal to approximately 60% of the anticipated output from 30 MW of solar energy facilities in the San Antonio area. Subsequent to the execution of this agreement, SunEdison transferred 100% of its interest in these facilities to San Antonio Solar Holdings LLC. A subsidiary of SunEdison continued as operator of these facilities. The unamortized balance of the prepayment was \$59.9 million at January 31, 2018, and \$63.0 million at January 31, 2017. The agreement expires in 2037, and the purchase of the balance of the output is on a pay-as-you-go basis. As part of the agreement, CPS Energy has the right to purchase the facilities six years after commencement of commercial operations, which occurred in May 2012. CPS Energy is currently considering its right to purchase the facilities, but no decision has been made.

- In July 2012, CPS Energy and OCI Solar Power (“OCI”) entered into an agreement for CPS Energy to purchase solar power produced by OCI. OCI created a consortium of partners to deliver approximately 400 MW of solar energy, produced at solar farms primarily in and around San Antonio, to CPS Energy throughout the life of the 25-year power purchase agreement. Also as part of the agreement, Mission Solar Energy, LLC, the anchor manufacturer in the consortium, has built a high-tech manufacturing facility to produce components for solar power generation and has relocated its headquarters to San Antonio, creating over 400 jobs in total. The table below represents the OCI solar farms included in the 25-year power purchase agreement:

<u>Name</u>	<u>Capacity in MW</u>	<u>Achieved Commercial Operations</u>
Alamo 1	40.7	December 2013
Alamo 2	4.4	March 2014
Alamo 3	5.2	January 2015
Alamo 4	39.6	August 2014
Alamo 5	95.0	December 2015
Alamo 6	110.2	March 2017
Alamo 7	106.4	September 2016

In October 2015, CPS Energy and OCI entered into an agreement for CPS Energy to purchase an additional 50 MW of solar power produced by OCI. The solar energy will be delivered to CPS Energy by the same consortium of partners throughout the life of the 25-year power purchase agreement. This facility, Pearl, achieved commercial operation in October 2017.

In March 2017, CPS Energy entered into an agreement to purchase an additional 50 MW of solar power produced by OCI. This is a 25-year purchase power agreement and the facility will be located in West Texas and is expected to be operational in calendar year 2018.

- In December 2013, CPS Energy, along with partners Silver Spring Networks and Landis+Gyr, began the Company’s Grid Optimization project, or more commonly known as Smart Grid. The project will provide a standards-based networking platform, advanced metering infrastructure and distribution automation solutions across CPS Energy’s service territory. The completed system will also facilitate wireless two-way communication between CPS Energy and its customers, allow for increased energy efficiency and offer greater customer control and savings. The project is on schedule to be completed in the summer of 2018. The estimated cost of this project is approximately \$290 million and has brought approximately 40 jobs to San Antonio as of January 31, 2018.
- Simply Solar is the trademarked name for CPS Energy’s pilot solar initiatives – Roofless Solar and SolarHostSA. Roofless Solar is being offered by CPS Energy in partnership with Clean Energy Collective (“CEC”). CEC built and maintains a 1-MW community solar farm in the CPS Energy service territory and sold 107.5 Watt panels in the array to customers who wanted to enjoy the benefits of solar power without having to install their own system. On June 18, 2015, CPS Energy entered into an agreement to purchase the output from the solar farm for 25 years. For the SolarHostSA program, CPS Energy partnered with PowerFin Partners to install up to 10 MW of rooftop systems on customer homes and businesses. CPS Energy opted to limit the size of this pilot program to a maximum of 5 MW. The program provides participating customers a monthly credit for hosting the systems on their rooftops. The program makes solar accessible to more customers by eliminating the significant upfront cost of traditional rooftop systems. On August 12, 2015, CPS Energy entered into an agreement to purchase the output from the rooftop systems for an initial term of 20 years.

In June 2018, the Company awarded a construction contract to renovate the new corporate headquarters to Sundt Construction. The Board approved a guaranteed maximum price of \$145 million. CPS Energy also made provisions for a \$5 million contingency fund which may be used to fund additional requirements related to the headquarters project. The Company expects to start moving its employees into the renovated headquarters during 2020.

In FY 2018, CPS Energy entered into a 50-year agreement with Joint Base San Antonio ("JBSA") to operate and maintain the natural gas and the electric utility systems at JBSA Randolph, Lackland and Lackland Training Annex. The Department of Defense ("DOD") will transfer ownership of these systems to CPS Energy for a total of \$42.0 million. The agreement includes a \$4.5 million cost reimbursable transition period that closes on December 31, 2018. CPS Energy will acquire the natural gas and electric assets through a bill of sale effective January 1, 2019. The DOD will reimburse CPS Energy for the costs to operate, maintain and upgrade these systems at a net present value of \$243.0 million throughout the contract term.

## 16. Leases

### Capital Leases

CPS Energy was not a contracted party to any capital leases during FY 2018 or FY 2017, either as a lessee or lessor.

### Operating Leases

**Leases Related to Communication Towers Sale** – In FY 2014, the Company entered into an agreement to sell 69 of its communication towers to an independent third party. Title to 62 of the towers was conveyed to the purchaser in January 2014. Resolution of easement issues related to the remaining sites was concluded in early FY 2017, resulting in the transfer of title to the purchaser for five additional towers for a total of 67 towers. CPS Energy retained title to the remaining two towers. Additionally, new licensing agreements were entered into between CPS Energy and the purchaser for CPS Energy's ongoing use of the towers and the purchaser's use of CPS Energy's communication buildings for a period of 40 years, with three five-year options by the purchaser to extend the agreement. See Note 4 – Capital Assets, Net for additional information related to the sale.

In accordance with lease guidance provided in GASB Statement No. 62, leases related to the communication towers sale, both with CPS Energy as lessor and as lessee, have been classified as operating leases. Future minimum lease payment information provided in this footnote includes lease revenue and lease expense to be recognized as a result of the following lease components of the communication towers sale:

- **Lease of Tower Space for CPS Energy Communication Equipment** – The parties to the sale transaction agreed that no cash would be paid by CPS Energy for the space it leased on the communication towers for the 40-year term of the lease agreement. As a result, the total sale transaction proceeds received from the purchaser were reduced by an amount representing an advance payment to the purchaser of the net present value of the estimated total lease obligation. This value represents a prepaid lease expense to the Company, benefitting a period of time equal to the 40-year term of the leases. In accordance with GASB Statement No. 62, the value of this prepaid lease obligation for space on the 67 towers was recorded at fair value and totaled \$20.2 million, which is being amortized to lease expense over the 40-year term.

- **Lease of Communication Building Space** – The parties agreed that no cash would be paid by the purchaser for the space it leased in CPS Energy’s communication buildings for the term of the lease agreement. As a result, the total sale transaction proceeds received from the purchaser included an additional amount representing an advance payment by the purchaser of the net present value of the estimated total lease obligation. This value represents unearned lease revenue to CPS Energy to be generated over a period of time equal to the 40-year term of the leases. In accordance with GASB Statement No. 62, the value of this unearned lease revenue for space in the 67 communication buildings was recorded at fair value and totaled \$6.8 million, which is being amortized to nonoperating income over the 40-year term.

Additionally, the communication towers sale transaction included an assignment of existing operating lease agreements with tenants who had equipment located on the towers. At the time of sale, there were approximately 127 lease agreements outstanding, with CPS Energy as lessor for space on the towers and in the Company’s communication buildings, having remaining terms varying from fewer than two years to ten years. In FY 2014, these leases provided approximately \$2.8 million in proceeds to the Company, which was recognized as nonoperating income. With the sale of the towers, these leases were assigned to the purchaser, and the right to collect future cash flows from the leases was conveyed. The estimated net present value of these cash flows, including annual escalations based on estimated future Consumer Price Indices, totaled approximately \$6.5 million for the 62 towers conveyed in the initial closing plus an additional \$0.5 million for the five towers subsequently conveyed. Proceeds to the Company from the towers sale transaction included a purchase price for these leases, which was recorded as a deferred inflow of resources totaling \$6.5 million in accordance with guidance provided in GASB Statement No. 65. As of January 31, 2018 and 2017, the balance of unearned revenue reported as a deferred inflow of resources was \$3.3 million and \$4.3 million, respectively. Revenue from the sale of future revenues related to these leases will be recognized over the term of the original leases in accordance with guidance provided in GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Equity Transfers of Assets and Future Revenues*.

Following is a brief description of CPS Energy’s current leases, as well as future minimum payments and receipts related to those leases.

**CPS Energy as Lessee** – CPS Energy has entered into operating lease agreements to secure the usage of communication towers space, railroad cars, natural gas storage facilities, land, office space, parking lot space and engineering equipment. The lease for the parking lot space and several of the leases for office space, as well as the lease of communication towers space, include an escalation in the monthly payment amount after the first year of each lease.

CPS Energy's projected future minimum lease payments for noncancelable operating leases with terms in excess of one year are as follows:

(In thousands)	
<u>Year Ended January 31,</u>	<u>Operating Lease Payments</u>
2019	\$ 7,132
2020	4,912
2021	3,062
2022	1,555
2023	1,519
Thereafter	<u>72,809</u>
Total future minimum lease payments	<u>\$ 90,989</u>

CPS Energy's minimum lease payments for all operating leases for which the Company was the lessee amounted to \$10.1 million in FY 2018 compared to \$9.9 million in FY 2017. Contingent lease payments amounted to \$0.05 million in FY 2018 and \$0.1 million in FY 2017.

**CPS Energy as Lessor** – CPS Energy has entered into operating lease agreements allowing cable and telecommunication companies to attach telephone, cable and fiber-optic lines to CPS Energy's electric poles. Operating leases also exist between CPS Energy and telecommunication companies allowing the companies to attach communication equipment to CPS Energy's communication and transmission towers. As described above, CPS Energy sold 67 of its communication towers to a third party in January 2014.

CPS Energy has three operating leases for the use of land that the Company owns, and it has entered into multiple agricultural leases allowing the lessees to use CPS Energy's land for sheep and cattle grazing. The three land leases contain provisions for contingent lease receipts based on the Consumer Price Index. Additionally, the majority of the operating leases pertaining to the use of CPS Energy's transmission towers contain provisions for contingent lease receipts that will equal the lesser of a 15% increase in the prior five-year lease payment or the percentage increase in the Consumer Price Index over the same five-year period.

Projected future minimum lease receipts to CPS Energy for noncancelable operating leases with terms in excess of one year are as follows:

(In thousands)	
<u>Year Ended January 31,</u>	<u>Operating Lease Receipts</u>
2019	\$ 1,050
2020	849
2021	799
2022	817
2023	648
Thereafter	<u>24,037</u>
Total future minimum lease receipts	<u>\$ 28,200</u>

CPS Energy's minimum lease receipts for all operating leases for which the Company was the lessor amounted to \$8.4 million in FY 2018 and \$7.8 million in FY 2017. Contingent lease receipts amounted to \$0.03 million in FY 2018 and FY 2017. There were no sublease receipts in FY 2018 or FY 2017.

## **17. Pollution Remediation Obligation**

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, requires that a liability be recognized for expected outlays for remediating existing pollution when certain triggering events occur. The general nature of existing pollution that has been identified at CPS Energy sites is consistent with that experienced within the electric and gas utilities industry. Under most circumstances, the triggering event most relevant to the Company is the voluntary commencement of activities to clean up pollution.

Under Federal Energy Regulatory Commission guidance, reserves have been established for dismantling and closure costs. In FY 2008, in preparation for implementation of GASB Statement No. 49, a portion of those reserves were reclassified to remediation and dismantling reserve accounts reported on the Statements of Net Position within other liabilities. When a triggering event occurs, those reserves will be reclassified as a pollution remediation liability also reported within other liabilities.

The pollution remediation liability was \$2.6 million and \$3.4 million as of January 31, 2018 and 2017, respectively. Costs were estimated using the expected cash flow technique prescribed under GASB Statement No. 49, utilizing information provided by the Company's environmental staff and consultants.

## **18. Subsequent Event**

In March 2018, NRG Energy, Inc. ("NRG") filed its December 31, 2017, Form 10-K with the SEC in which the company recognized an impairment loss of \$1.2 billion related to its subsidiary, NRG South Texas LP's, 44% interest in STP Units 1 and 2. The impairment was primarily due to the revised outlook of future commodity prices and NRG management's view of a decrease in future cash flows from STP operations as a result of accounting requirements under Financial Accounting Standards Board. CPS Energy does not expect to write-down its investment in STP Units 1 and 2 as a result of this news.

## REQUIRED SUPPLEMENTARY INFORMATION (“RSI”) January 31, 2018 and 2017 (Unaudited)

**Schedules of Changes in CPS Energy Net Pension Liability and Related Ratios** – The following schedules present multiyear trend information that demonstrates the components of change in the net pension liability from year to year, as well as trends in related statistical information. Information is presented related to all periods for which the required data is available. Amounts are presented on a net pension liability measurement date basis for the following periods:

(Dollars in thousands)

	Measurement Period Ended January 31,					
	2017	2016	2015	2014	2013	2012
<b>Total pension liability</b>						
Service cost	\$ 31,547	\$ 30,183	\$ 32,591	\$ 33,417	\$ 33,470	\$ 31,420
Interest cost	128,991	122,800	117,802	116,155	112,356	105,013
Changes in assumptions	-	-	38,296	-	-	-
Differences between expected and actual experience	(18,647)	19,691	(35,634)	(24,410)	25,158	(13,581)
Benefit payments	(91,230)	(91,293)	(84,319)	(74,352)	(70,677)	(66,147)
Net change in total pension liability	50,661	81,381	68,736	50,810	100,307	56,705
Total pension liability, beginning of period	1,734,177	1,652,796	1,584,060	1,533,250	1,432,943	1,376,238
Total pension liability, end of period	1,784,838	1,734,177	1,652,796	1,584,060	1,533,250	1,432,943
<b>Plan fiduciary net position</b>						
Employer contributions	(44,500)	(46,000)	(55,800)	(44,400)	(39,016)	(37,687)
Participant contributions	(12,144)	(11,563)	(12,140)	(12,569)	(12,332)	(11,745)
(Earnings) loss on Plan assets	(207,196)	52,945	(85,520)	(145,883)	(110,529)	(22,510)
Benefit payments	91,230	91,293	84,319	74,352	70,677	66,147
Net change in Plan fiduciary net position	(172,610)	86,675	(69,141)	(128,500)	(91,200)	(5,795)
Plan fiduciary net position, beginning of period	(1,299,766)	(1,386,441)	(1,317,300)	(1,188,800)	(1,097,600)	(1,091,805)
Plan fiduciary net position, end of period	(1,472,376)	(1,299,766)	(1,386,441)	(1,317,300)	(1,188,800)	(1,097,600)
Net pension liability, end of period	\$ 312,462	\$ 434,411	\$ 266,355	\$ 266,760	\$ 344,450	\$ 335,343
Plan fiduciary net position as a percentage of the total pension liability	82.5%	74.9%	83.9%	83.2%	77.5%	76.6%
Covered payroll	\$ 235,360	\$ 256,236	\$ 261,085	\$ 260,730	\$ 251,136	\$ 241,318
Net pension liability as a percentage of covered payroll	132.8%	169.5%	102.0%	102.3%	137.2%	139.0%

**Notes to Schedule**

For FY 2018 and FY 2017, the annual investment rate of return underlying the calculation of total pension liability was assumed to be 7.50%. For the previous years presented, the rate used was 7.75%. No other actuarial assumptions were modified in FY 2018. Other actuarial assumptions were modified in FY 2016 without significantly affecting trends in the amounts reported above. There were no changes in benefit terms, in the size or composition of the population covered by the benefit terms, or other factors that significantly affected trends from year to year in the amounts reported above.

**Schedules of Employer Contributions to CPS Energy Pension Plan** – The following schedules, present multiyear trend information regarding employer contributions to the Plan. Information is presented related to all periods for which the required data is available. The amounts presented are determined as of the fiscal years ending:

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Actuarially determined contribution	\$ 46,234	\$ 44,532	\$ 46,001	\$ 48,696	\$ 44,362	\$ 39,016
Contributions in relation to the actuarially determined contribution	<u>46,200</u>	<u>44,500</u>	<u>46,000</u>	<u>55,800</u>	<u>44,400</u>	<u>39,016</u>
Contribution deficiency (excess)	<u>\$ 34</u>	<u>\$ 32</u>	<u>\$ 1</u>	<u>\$ (7,104)</u>	<u>\$ (38)</u>	<u>\$ -</u>
Covered payroll	<b>\$242,477</b>	\$ 235,360	\$ 256,236	\$ 261,085	\$ 260,730	\$ 251,136
Contributions as a percentage of covered payroll	<b>19.1%</b>	18.9%	18.0%	21.4%	17.0%	15.5%

**Notes to Schedule**

*Valuation date:* Actuarially determined contribution rates are calculated as of January 1, two years and one month prior to the end of the fiscal year in which contributions are made.

*Methods and assumptions used to determine contribution rates:*

Actuarial cost method	Entry-age normal cost
Amortization method	Level dollar
Remaining amortization period	30 years
Asset valuation method	Market value gains/losses recognized over 5 years, beginning with calendar year 2014; expected value adjusted market value method for all prior periods
Inflation	3.0% per year, compounded annually
Salary increases	Average, including inflation: 4.66% for FY 2018, 4.78% for FY 2017, 5.01% for FY 2016, 5.03% for FY 2015, 5.07% for FY 2014, 5.18% for FY 2013
Investment rate of return	7.50% per year, compounded annually, for FY 2018, 2017 and 2016, 7.75% for prior years
Mortality	Based on RP-2000 Combined Healthy Annuitant Mortality Table for Males or Females, projected using Scale BB for 2017 and 2016; RP-2000 Combined Healthy Annuitant Mortality Table for Males or Females, projected using Scale AA for prior years.
Cost-of-living increases	1.50% per year

*Other information:* For FY 2018, FY 2017 and FY 2016, the annual investment rate of return underlying the calculation of total pension liability was assumed to be 7.50%. For the previous years presented, the rate used was 7.75%. No other actuarial assumptions were modified in FY 2018. Other actuarial assumptions were modified in FY 2016 without significantly affecting trends in the amounts reported above. There were no changes in benefit terms, in the size or composition of the population covered by the benefit terms, or other factors that significantly affected trends from year to year in the amounts reported above.

**Schedules of Changes in CPS Energy Net OPEB Liability and Related Ratios** – The following schedules present multiyear trend information that demonstrates the components of change in the net OPEB liability from year to year, as well as trends in related statistical information. Information is presented related to all periods for which the required data is available. Amounts are presented on a net OPEB liability measurement date basis for the following periods:

### Health Plan

(Dollars in thousands)

	Measurement Period Ended January 31,		
	2017	2016	2015
<b>Total OPEB liability</b>			
Service cost	\$ 3,435	\$ 3,319	\$ 3,207
Interest cost	18,176	17,601	17,050
Changes in Plan benefits	(19,185)	-	-
Changes in assumptions	-	-	-
Differences between expected and actual experience	475	-	-
Benefit payments	(14,001)	(12,756)	(13,275)
Net change in total OPEB liability	(11,100)	8,164	6,982
Total OPEB liability, beginning of period	245,908	237,744	230,762
Total OPEB liability, end of period	234,808	245,908	237,744
<b>Plan fiduciary net position</b>			
Employer contributions	(8,500)	(8,806)	(3,200)
Participant contributions	(6,802)	(6,734)	(6,024)
Medicare Part D payment	(933)	(976)	(933)
(Earnings) loss on Plan assets	(38,949)	9,765	(12,536)
Benefit payments	20,804	19,490	19,299
Administrative expense	1,621	1,456	1,137
Net change in Plan fiduciary net position	(32,759)	14,195	(2,257)
Plan fiduciary net position, beginning of period	(227,889)	(242,084)	(239,827)
Plan fiduciary net position, end of period	(260,648)	(227,889)	(242,084)
Net OPEB liability (asset), end of period	\$ (25,840)	\$ 18,019	\$ (4,340)
Plan fiduciary net position as a percentage of the total OPEB liability	111.0%	92.7%	101.8%
Covered payroll	\$ 223,523	\$ 215,964	\$ 242,652
Net OPEB (asset) liability as a percentage of covered payroll	-11.6%	8.3%	-1.8%

#### Notes to Schedule

In FY 2018, claim costs were updated to reflect plan changes and to reflect recent experience. Medical and prescription trend was reset in FY 2018, FY 2017 and FY 2016.

**Life Plan**

(Dollars in thousands)

	Measurement Period Ended January 31,		
	2017	2016	2015
<b>Total OPEB liability</b>			
Service cost	\$ 336	\$ 325	\$ 313
Interest cost	3,256	3,244	3,228
Changes in assumptions	-	-	-
Differences between expected and actual experience	2,378	-	-
Benefit payments	<b>(3,469)</b>	<b>(3,358)</b>	<b>(3,313)</b>
Net change in total OPEB liability	<b>2,501</b>	211	228
Total OPEB liability, beginning of period	<b>44,788</b>	44,577	44,349
Total OPEB liability, end of period	<b>47,289</b>	44,788	44,577
<b>Plan fiduciary net position</b>			
Employer contributions	-	-	-
Participant contributions	<b>(972)</b>	(930)	(911)
(Earnings) loss on Plan assets	<b>(6,936)</b>	2,102	(2,460)
Benefit payments	<b>3,469</b>	3,358	3,313
Administrative expenses	<b>27</b>	21	16
Net change in Plan fiduciary net position	<b>(4,412)</b>	4,551	(42)
Plan fiduciary net position, beginning of period	<b>(45,286)</b>	(49,837)	(49,795)
Plan fiduciary net position, end of period	<b>(49,698)</b>	(45,286)	(49,837)
Net OPEB (asset) liability, end of period	<b>\$ (2,409)</b>	\$ (498)	\$ (5,260)
Plan fiduciary net position as a percentage of the total OPEB liability	<b>105.1%</b>	101.1%	111.8%
Covered payroll	<b>\$ 198,704</b>	\$ 191,984	\$ 218,939
Net OPEB (asset) liability as a percentage of covered payroll	<b>-1.2%</b>	-0.3%	-2.4%

**Notes to Schedule**

The annual investment rate of return underlying the calculation of total OPEB liability was assumed to be 7.50%. There were no changes in benefit terms, in the size or composition of the population covered by the benefit terms, or other factors that significantly affected trends from year to year in the amounts reported above.

**Disability Plan**

(Dollars in thousands)

	Measurement Period Ended January 31,		
	2017	2016	2015
<b>Total OPEB liability</b>			
Service cost	\$ 527	\$ 509	\$ 492
Interest cost	455	448	426
Changes in assumptions	-	-	-
Differences between expected and actual experience	255	-	-
Benefit payments	(974)	(775)	(559)
Net change in total OPEB liability	263	182	359
Total OPEB liability, beginning of period	6,032	5,850	5,491
Total OPEB liability, end of period	6,295	6,032	5,850
<b>Plan fiduciary net position</b>			
Employer contributions	(700)	(175)	(175)
Participant contributions	(260)	(248)	(211)
(Earnings) loss on Plan assets	(501)	158	(177)
Benefit payments	974	775	559
Administrative expense	15	14	18
Net change in Plan fiduciary net position	(472)	524	14
Plan fiduciary net position, beginning of period	(3,762)	(4,286)	(4,300)
Plan fiduciary net position, end of period	(4,234)	(3,762)	(4,286)
Net OPEB liability, end of period	\$ 2,061	\$ 2,270	\$ 1,564
Plan fiduciary net position as a percentage of the total OPEB liability	67.2%	62.4%	73.3%
Covered payroll	\$ 212,904	\$ 205,704	\$ 218,939
Net OPEB liability as a percentage of covered payroll	1.0%	1.1%	0.7%

**Notes to Schedule**

The annual investment rate of return underlying the calculation of total OPEB liability was assumed to be 7.50%. There were no changes in benefit terms, in the size or composition of the population covered by the benefit terms, or other factors that significantly affected trends from year to year in the amounts reported above.

**Schedules of Employer Contributions to CPS Energy OPEB Plans** – The following schedules, present multiyear trend information regarding employer contributions to the OPEB Plans. Information is presented related to all periods for which the required data is available. The amounts presented are determined as of the fiscal years ending:

**Health Plan**

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Actuarially determined contribution	\$ -	\$ -	\$ -
Contributions in relation to the actuarially determined contribution	-	8,500	8,806
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ (8,500)</u>	<u>\$ (8,806)</u>
Covered payroll	<b>\$220,522</b>	\$ 223,523	\$ 215,964
Contributions as a percentage of covered payroll	<b>0.0%</b>	3.8%	4.1%

**Notes to Schedule**

*Valuation date:* Actuarially determined contribution rates are calculated as of January 1, two years and one month prior to the end of the fiscal year in which contributions are made.

*Methods and assumptions used to determine contribution rates:*

Actuarial cost method	Entry-age normal cost
Amortization method	Level dollar
Remaining amortization period	30 years
Asset valuation method	Market value gains/losses recognized over 5 years
Healthcare cost trend rates	7.0% initial, decreasing to an ultimate rate of 5.0% for FY 2018, 7.5% initial, decreasing to an ultimate of 5.0% for FY 2017 and FY 2016
Prescription cost trend rates	7.0% initial, decreasing to an ultimate rate of 5.0% for FY 2018, 8.5% initial, decreasing to an ultimate of 5.0% for FY 2017 and FY 2016
Salary increases	Projected average annual salary increases ranging from 4.0% to 9.5% depending on age
Investment rate of return	7.50% per year, compounded annually
Mortality	Based on RP-2000 Combined Healthy, with No Collar Adjustment, Projected to 2020 using Scale BB, Male and Female Tables for Active and Retirees; Based on 1987 Commissioners Group Disabled Life Mortality Table for Disabled

*Other information:* For FY 2018 claim costs were updated to reflect plan changes and to reflect recent experience. The medical and prescription trend was reset. No other actuarial assumptions were modified in FY 2018. For FY 2017 and FY 2016 claim costs were updated to reflect recent experience, and the medical and prescription trend was reset.

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**Life Plan**

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Actuarially determined contribution	\$ 515	\$ 145	\$ 561
Contributions in relation to the actuarially determined contribution	-	-	-
Contribution deficiency (excess)	<u>\$ 515</u>	<u>\$ 145</u>	<u>\$ 561</u>
Covered payroll	<b>\$210,631</b>	\$ 198,704	\$ 191,984
Contributions as a percentage of covered payroll	<b>0.0%</b>	0.0%	0.0%

**Notes to Schedule**

*Valuation date:* Actuarially determined contribution rates are calculated as of January 1, two years and one month prior to the end of the fiscal year in which contributions are made.

*Methods and assumptions used to determine contribution rates:*

Actuarial cost method	Entry-age normal cost
Amortization method	Level dollar
Remaining amortization period	30 years
Asset valuation method	Market value gains/losses recognized over 5 years
Inflation	3.0% per year, compounded annually
Salary increases	4.78% average, including inflation
Investment rate of return	7.50% per year, compounded annually
Mortality	Based on RP-2000 Combined Healthy, with No Collar Adjustment, Projected to 2020 using Scale BB, Male and Female tables for actives and retirees; 1987 Commissioners Group Disabled Life Mortality table for disabled lives

*Other information:* There were no changes in benefit terms, in the size or composition of the population covered by the benefit terms, or other factors that significantly affected trends from year to year in the amounts reported above.

**Disability Plan**

(Dollars in thousands)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Actuarially determined contribution	\$ 1,035	\$ 886	\$ 793
Contributions in relation to the actuarially determined contribution	<u>1,300</u>	<u>700</u>	<u>175</u>
Contribution deficiency (excess)	<u>\$ (265)</u>	<u>\$ 186</u>	<u>\$ 618</u>
Covered payroll	<b>\$216,558</b>	\$ 212,904	\$ 205,704
Contributions as a percentage of covered payroll	<b>0.6%</b>	0.3%	0.1%

**Notes to Schedule**

*Valuation date:* Actuarially determined contribution rates are calculated as of January 1, two years and one month prior to the end of the fiscal year in which contributions are made.

*Methods and assumptions used to determine contribution rates:*

Actuarial cost method	Entry-age normal cost
Amortization method	Level dollar
Remaining amortization period	30 years
Asset valuation method	Market value gains/losses recognized over 5 years
Inflation	3.0% per year, compounded annually
Salary increases	4.78% average, including inflation
Investment rate of return	7.50% per year, compounded annually
Mortality	Based on 1987 Commissioners Group Disabled Life Mortality table

*Other information:* During FY 2016, plan changes to provide employees with immediate coverage and an option to increase the benefit from 50% of pay to 70% of pay, less Social Security Disability Benefits and other offsets were reflected in the valuation.

## GLOSSARY OF TERMS

**Advance Refunding:** A bond issuance in which new bonds are sold at a lower interest rate than outstanding ones. The proceeds are then invested in an irrevocable escrow; when the older bonds become callable, they are paid off with the invested proceeds.

**Allowance for Funds Used During Construction (“AFUDC”):** A cost accounting procedure whereby interest charges on borrowed funds and a return on equity for capital used to finance construction are added to the cost of utility plant being constructed (i.e., capitalized interest).

**Amortize:** To reduce an original amount or an account balance on an installment basis.

**Assets:** Resources with present service capacity that a governmental entity presently controls.

**Build America Bonds (“BABs”):** Taxable municipal bonds created under the American Recovery and Reinvestment Act of 2009 that carry special federal subsidies for either the bondholder or the bond issuer.

**Call Option:** An option contract giving the owner the right (but not the obligation) to buy a specified amount of an underlying asset at a specified price within a specified time.

**Capital Asset:** An asset with a life of more than one year that is not bought and sold in the ordinary course of business.

**Cash and Cash Equivalents:** The value of assets that can be converted into cash immediately. Usually includes bank accounts and marketable securities, such as government bonds. Cash equivalents on the Statements of Net Position include securities with an original maturity of 90 days or less.

**Commercial Paper:** A short-term note with a maximum maturity of 270 days. Maturities for commercial paper notes, however, can be extended indefinitely for the life of the program that supports the commercial paper notes.

**Community Infrastructure and Economic Development (“CIED”) Fund:** Used to support qualified capital projects that provide economic benefit within the communities served by CPS Energy.

**Component Unit:** A legally separate entity for which the elected officials of the primary government are financially accountable and with which a financial benefit/burden relationship exists. The nature and significance of its relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

**Decommissioning:** The process related to permanently taking a nuclear plant out of service, including decontaminating and removing buildings or other structures.

**Defeasance:** A provision that legally discharges a borrower for debt incurred when the borrower sets aside cash or bonds sufficient to service the outstanding debt.

**Deferred Inflows of Resources:** Acquisition of net assets applicable to a future reporting period.

**Deferred Outflows of Resources:** Consumption of net assets applicable to a future reporting period.

**Depreciation:** Amount allocated during the period to expense the cost of acquiring a capital asset over the useful life of the asset.

**Derivative:** In finance, a security for which price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Examples of derivatives include futures and options.

**Electric Reliability Council of Texas (“ERCOT”):** An organization whose mission is to direct and ensure reliable and cost-effective operation of the electric transmission grid in Texas and to enable fair and efficient market-driven solutions to meet customers’ electric service needs.

**Fair Value:** The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**Federal Energy Regulatory Commission (“FERC”):** Independent federal agency created within the U.S. Department of Energy. FERC is vested with broad regulatory authority over wholesale electric, natural gas and oil production, and the licensing of hydroelectric facilities.

**Financial Accounting Standards Board (“FASB”):** Board composed of independent members who create and interpret generally accepted accounting principles (“GAAP”) applicable to private sector entities in the United States.

**Fiscal Year (“FY”):** The 12-month period covered by the income statement. A fiscal year may or may not coincide with a calendar year. For CPS Energy, the fiscal year is from February 1 through January 31.

**Futures:** Financial contracts obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange.

**Generally Accepted Accounting Principles (“GAAP”):** Conventions, rules and procedures that serve as the norm for the fair presentation of financial statements. The Governmental Accounting Standards Board is responsible for setting GAAP for state and local governments.

**Governmental Accounting Standards Board (“GASB”):** The authoritative standard-setting

body for accounting and financial reporting for governmental entities in the United States.

**Hedging:** The process of buying and selling fuel oil; natural gas; diesel fuel; and electric energy futures, options or similar contracts to limit risk of loss caused by price fluctuations.

**Lease:** A legal agreement to pay rent to the lessor for a stated period of time. Sometimes the lease is in substance a purchase of an asset and a financing arrangement (i.e., a capital lease).

**Lease/Leaseback:** A financing transaction that involves a company leasing an asset to another entity and that entity subleasing the asset back to the company.

**Liabilities:** Present obligations to sacrifice resources that a governmental entity has little or no discretion to avoid.

**MMBtu:** 1,000,000 British Thermal Units (“BTU”). A BTU is the standard unit for measuring the quantity of heat energy, such as the heat content of fuel. It is the amount of heat energy necessary to raise the temperature of one pound of water one degree Fahrenheit at sea level pressure.

#### **Management’s Discussion & Analysis**

**(“MD&A”):** A section of the basic financial statements that contains objective and easily readable analysis from management about the company’s financial condition and its operations to assist users in assessing the company’s financial position.

**Megawatt (“MW”):** A measure of electric power. A megawatt equals 1,000 kilowatts or 1,000,000 watts.

**Mothballed:** A generation resource that is placed in an inactive state so that it can neither be brought into operation immediately nor counted towards the electric transmission grid’s reserve margin.

**National Association of Regulatory Utility Commissioners (“NARUC”):** A nonprofit organization whose members include the governmental agencies that are engaged in the

regulation of utilities and carriers in the 50 United States, the District of Columbia, Puerto Rico and the Virgin Islands. NARUC's member agencies regulate the activities of energy, water and telecommunications utilities.

**Natural Gas Basis Swap:** A financial contract that allows the purchaser to lock in the price difference between two natural gas delivery points or hubs, such as the Houston Ship Channel and Henry Hub, Louisiana.

**Net Costs Recoverable/Refundable:** Certain costs that are required to be accrued as a regulatory asset or a regulatory liability under GASB Statement No. 62 if regulation provides assurance that these costs can be recovered or refunded through rates in the future.

**Net OPEB (Asset) Liability:** The difference between the actuarial total OPEB liability and an OPEB plan's fiduciary net position of as the measurement date.

**Net Pension Liability:** The difference between the actuarial total pension liability and a pension plan's fiduciary net position of as the measurement date.

**Net Revenue:** Per the New Series Bond Ordinance, all income and revenues from the operation of the Company's electric and gas systems after the deduction of maintenance and operating expenses.

**New Series Bonds:** A CPS Energy term used to distinguish bonds that have a first lien on the net revenues of CPS Energy's Systems.

**Other Postemployment Benefits ("OPEBs"):** Postemployment benefits other than pension benefits. OPEBs include postemployment healthcare benefits, regardless of the type of plan that provides them, and all postemployment benefits provided separately from a pension plan, excluding benefits defined as termination benefits.

**Public Utility Commission of Texas ("PUCT"):** The governmental commission that regulates the rates and services of telephone utilities; investor-owned electric, water and sewer

utilities; electric, water and sewer utilities in unincorporated areas; and radio companies statewide. The PUCT does not have authority to regulate retail activities of municipally owned utilities.

**Refunding:** Retiring all or a portion of an outstanding bond issue after the first call date by using money from the sale of a new offering.

**Regulatory Asset/Liability:** Specific costs, revenues or gains that a government with qualifying rate-regulated operations is allowed to defer, until recovered through future rates, that would otherwise be immediately recognized in the statement of revenues, expenses and changes in net position.

**Required Supplementary Information ("RSI"):** Schedules, statistical data and other information that are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity.

**Retail Sales:** Retail electric sales within a utility's certificated service area. (Also see "Wholesale Sales.")

**Revenue Bonds:** Bonds issued by a municipality in which the issuer pledges to the bondholders its revenues as security for the bonds.

**SA Energy Acquisition Public Facility Corporation ("PFC"):** A public nonprofit corporation organized under the laws of the state of Texas pursuant to the Texas Public Facility Corporation Act, Chapter 303, Texas Local Government Code. The PFC was organized to assist the City of San Antonio in financing, refinancing or providing public facilities, including natural gas, to be devoted to public use.

**South Texas Project ("STP"):** A two-unit nuclear plant with a capacity of 2,700 MW of electricity, enough to provide service for more than one million homes and businesses.

**South Texas Project Nuclear Operating Company ("STPNOC"):** A not-for-profit entity

that provides for the licensing, construction, operation and maintenance of the jointly owned and operated electric generation facilities of STP.

**Tax-Exempt Bond:** A bond usually issued by a municipal, county or state government for which interest payments are not subject to the bondholders' federal income tax and, in some cases, state and local income tax.

**Transmission Costs of Service ("TCOS"):** A functional classification of expenses and capital expenditures relating to the operation and maintenance of the transmission plant. The transmission function is that portion of the utility system used for the purpose of transmitting electrical energy in bulk to other principal parts of the system or to other utility systems.

**True Interest Cost:** The rate, compounded semi-annually, necessary to discount the amounts payable on the respective principal and interest payment dates to the purchase price received for the new issue of bonds.

**Variable-Rate Demand Obligation:** A long-term bond with a floating interest rate that varies as it is redetermined periodically (daily, weekly, semi-annually, annually, etc.).

**Weighted-Average Duration ("WAD"):** The weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows and is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates.

**Weighted-Average Maturity ("WAM"):** The weighted-average time to return a dollar of principal based on an investment's stated final maturity. It is used as an estimate of the interest rate risk of a fixed-income investment.

**Wholesale Sales:** Wholesale electric sales outside a utility's certificated service area. (Also see "Retail Sales.")